FINANCIAL TIMES SURVEY

THE SOVIET UNION

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Section 3

A superpower in turmoil

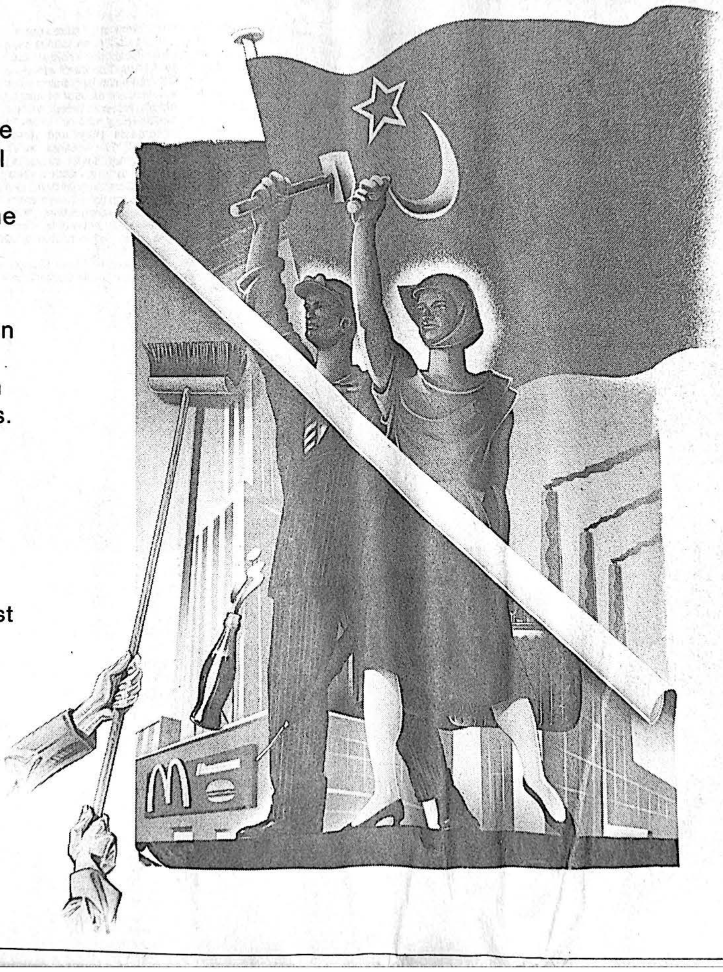
The Soviet Union is in the throes of a second social revolution, the effects of which may well be as far-reaching as the 1917 October Revolution which began the Socialist Experiment.

President Mikhail Gorbachev's perestroika is calling into question all the basic tenets of Soviet society, and the whole foundation of post-war international relations.

Already its effects across the world have been dramatic, in progress towards global disarmament, dismantling the superpower rivalry, bringing peace to regional conflicts and causing the collapse of communist rule throughout eastern Europe.

At home, the Communist Party has agreed to give up its monopoly of power, but the multi-party system to come is still clouded by uncertainty. And the economy is in dire crisis.

This survey assesses the problems and prospects for a superpower in turmoil.



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The Communist Party has lost its political authority, but does not know how to abandon its power

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If reform succeeds it will be largely because a state of law is painfully being built

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'We should turn all state property into shareholder property and create a stock exchange'

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'They should all read Lewis Carroll. This economy is like Alice in Wonderland'

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Having been given the right to say what they want, film makers are finding that they were more comfortable when they had something to fight

Mr Gorbachev has lifted the lid of reform and released an explosion of demands. **Quentin Peel** examines the impact

Teetering between revolution and disintegration

THE FUTURE of the Soviet Union is in the balance, teetering between revolution and disintegration.

On the outcome hangs the fate of President Mikhail Gorbachev, the outstanding world leader of the late 20th century, and a generation of middle-aged revolutionaries who have devoted their lives to waking their nation from more than 70 years of a "liturgical dream," to quote one of his closest advisers.

It is an outcome which will also have far-reaching consequences for the rest of the world, deciding whether the present climate of disarmament and co-operation can lead to a period of unprecedented stability and economic growth, or whether Europe will once again become a cockpit of squabbling nationalities, dominated by the awful prospect of a pauperised superpower with a huge nuclear arsenal.

This week, almost five years to the day since he succeeded as the Soviet Communist Party leader, Mr Gorbachev is set to become executive president of the Soviet Union – with sweeping powers virtually independent of the party which made him.

From one point of view, the move is a logical consequence of the process of democratisation which the Soviet leader embarked on in 1988, when he switched his priority from economic to political reform. It creates a directly elected presidency, its powers balanced by an elected parliament, and distances the once all-powerful party from the direct levers of power.

On the other hand, Mr Gorbachev's rush to push through drastic constitutional change, and create such a powerful presidency, can be seen as a gamble to save perestroika from the twin monsters it has spawned: the economic collapse of the old system, and the nationalist unravelling of the Soviet empire.

When he launched perestroika in 1985, even his closest advisers admit that he had no real inkling of the extent of the revolution it implied.

"He did not come with all his ideas prepared for perestroika," says Mr Georgi Shakhnazarov, the political scientist (and writer of science fiction) who is one of the three personal aides in his private office. "But he was prepared to the extent that he understood this system could not survive any longer, that we had to restructure and make really revolutionary changes in the system. Step by step, we go deeper."

The crucial point which the Soviet leader and his fellow revolutionaries seized was the need to "de-Stalinise" Soviet society, to remove all traces of the tyranny imposed by the Soviet dictator in every aspect of Soviet life, in the economy, politics, culture, even in sport.

The question that now has to be faced is whether de-Stalinisation does not inevitably mean the destruction of the communist system, the heritage of 1917, and starting again from scratch.

Mr Gorbachev is convinced that some sort of pragmatic Leninism is possible – a human socialism, with a multiplicity of economic and property forms (no rigid state monopoly), a revival of peasant farms (just as his own father had one), and above all, the recovery of individual initiative.

Parallel with that is his concept of a new Soviet federation – which he openly admits has never existed in the USSR beyond the empty words of the constitution. "Do you know what a federation is?" he asked of Lithuanians demanding outright secession. "How could you know? You have never lived in one."

Yet just as the republics are supposed to be getting the genuine autonomy which they are promised, Mr Gorbachev is establishing a strong central presidency. Can the two combine?

His most extraordinary achievement to date has been to persuade the representatives of the old regime to give up without the sort of backlash or bloodshed seen in Romania. Not only in the rest of eastern Europe, but also at home.

It was strikingly illustrated when the conservative majority in the ruling Soviet Communist Party central committee voted unanimously in February both to abandon Article Six of the constitution – entrenching the Party's effective monopoly of power – and agree to an executive presidency beyond the control of the Politburo. Speaker after conservative speaker had denounced the plans as a betrayal of all the Party stood for. Yet when it came to the vote, only Mr Boris Yeltsin, that professional rebel, voted against – because the plan was not radical enough.

It is as if the old hierarchies knew that they were bankrupt of ideas, and that their cosy old corruption might not be quite so brutally exposed if they went willingly.

Then Mr Gorbachev has also played a devastating, but high-risk, political hand. Unlike his predecessor, Mr Nikita Khrushchev, who tried to de-Stalinise the system from the top, and was overthrown by it, Mr Gorbachev has chosen deliberately to stimulate a revolution from below. On the eve of that crucial February plenum, popular revolts in the provinces overthrew a string of top conservative party leaders – in Volgograd, Tyumen, Sverdlovsk and elsewhere.

Now there is a real possibility that those mass demonstrations will continue, demanding not just the heads of the leaders, but of the whole party structure. The atmosphere in the country is extraordinarily tense, and there is a real fear of precipitating the sort of bloodshed unleashed by Ceausescu in Bucharest. Might this in turn produce a conservative coup?

"The process of perestroika has only lasted five years. I cannot say people have changed drastically," a government minister said recently. "We frequently used to use the word irreversible. Then suddenly we came to understand that only some things are irreversible. In human life, maybe only death is irreversible."

The problem is that when Mr Gorbachev lifted the lid of reform, he released two forces: an explosion of pent-up demands, both nationalist and economic, and an explosion of ideas.

The first sort of explosion has meant that even where perestroika has improved the situation, expectations have grown even faster. There is today far more regional autonomy from Moscow already – not least because the old lines of command have broken down. Yet nationalists demand outright independence, even where all logic is against it. The promise of federalism has done nothing to appease them.

On the economic front, it is not true that all production has slumped. Production of television sets, for example, increased by as much as 20 per cent. Yet there are none in the shops. The answer is twofold: the official retail system has collapsed, to be replaced by alternative distribution routes through factories – and the black market; and demand has risen even faster than supply.

The raised expectations have also affected the whole attitude to reform. The latest elections for republican parliaments saw a dangerous amount of apathy among voters, faced with a bewildering choice between candidates they had never heard of. The viewers watch the Supreme Soviet struggling to come to terms with a genuine parliamentary system, and see only wrangling over procedure: they want action, goods in the shops, not words. There is a crisis of confidence in perestroika.

Yet the explosion of ideas is, on balance, to Mr Gorbachev's advantage. Young people have burst out of the ideological shackles (removed their "ideological spectacles," as Mr Nikolai Petrakov, Mr Gorbachev's economic adviser, puts it) and are embracing new forms of economic and political activity with a vengeance. This is just beginning to make inroads into the decades of government propaganda, and deep-seated peasant suspicion, that have undermined any effort at entrepreneurial spirit.

The result is fairly anarchic, or for the potential foreign investor looking for a joint venture, something like coming to the Wild West. But if that energy explosion can be harnessed into a new system, it provides Mr Gorbachev with his chance.

Whether he succeeds in the end or not, Mr Gorbachev's survival so far is remarkable: he has shown an ability to adapt to changing political circumstances, to outmanoeuvre a conservative majority in all the leading institutions of the state and party. He has certainly benefited from the fact that a great creaking empire can suffer revolts at its fringes, and still not fall apart.

And one human achievement must not go unrecorded: Mr Gorbachev has reduced – not yet entirely abolished – the fear which used to permeate the system. Glasnost means that ordinary people worry far less about speaking their minds.

"Fear is genetically to be found in our people," says Mr Vyacheslav Shostakovsky, Rector of the Moscow Higher Party School, and a leader of the social democratic reformers within the Communist Party. "Many people said when perestroika began that its purpose was simply to identify the dissidents and bring them to the wall. Now at last the people's mood is beginning to change."

Even if Mr Gorbachev does not survive the course – the nine years' more as president he can constitutionally expect – if he abolishes the fear in the system, it will have been an extraordinary achievement.

A cartoon by I.Smirnov from a book of satirical cartoons entitled Joking Aside (Progress Publishers Moscow). The book takes a sideways look at the era of perestroika

KEY ECONOMIC STATISTICS

	1989	1988	1980
GNP total ($bn 1985)	2,144.6	2,154.8	1852.6
By sector of origin			
Industry	744.5	757.6	642.4
Agriculture	415.6	413.5	364.8
Other productive sectors	557.8	559.6	456.7
Non-productive sectors	426.7	424.1	388.7
Percentage growth:	**1989**	**1988**	**1980/89**
GNP total	-0.5	+1.6	+2.9
By sector of origin			
Industry	-1.7	+1.5	+1.6
Agriculture	+0.5	+1.0	+1.4
Productive sectors	-0.3	+2.7	+2.3
Non-productive sectors	+0.6	+0.2	+0.9
Balance of payments in convertible currencies ($bn)	**1989**	**1988**	**1980**
Merchandise Exports	Not	43.1	38.2
Merchandise imports	available	38.9	34.8
Balance		4.2	3.4
Invisibles		-0.4	-0.6
Current Account		+3.8	+2.8
Imports and exports by direction		**1989**	**1988**
Imports world		Not	107.9
EC-East		available	57.84
EC-West			29.82
Other			19.43
Exports world		Not	110.51
EC-East		available	54.12
EC-West		for 1989	27.41
Other			28.97

Source: Plan Econ; UN

POLITICS

Quentin Peel reports on the rise of the parliamentary system

Thriller for armchair viewers

AS IF glasnost were not enough, Soviet television viewers have suddenly been given a whole new galaxy of stars to contend with.

Every night at 7pm the new soap opera begins. There are familiar villains, flawed heroes and heroines, a querulous question-master, and lots of confusion, with the plots often being rewritten in the course of the drama.

The stars are people like Mr Yuri Sobchak, a rising lawyer from Leningrad, with a natty line in loud checked jackets; or Mr Valentina Shevchenko, an unrepentantly conservative old *babushka* from Kiev; Mr Veniamin Yarin, the populist hero of industrial working classes of the Ural mountains and scourge of the intelligentsia; and of course battling Mr Boris Yeltsin.

The setting is the Supreme Soviet, coming to the viewers almost live from the Kremlin. Occasionally they are treated to a bumper issue, known as the Congress of People's Deputies, with five times as many actors, and proportionally more mayhem.

The whole process is called learning to build a parliamentary system in public, and it is possibly the most important single achievement of President Mikhail Gorbachev's perestroika process so far.

Confusion is inevitable for participants who only one year ago were used to a parliament which met for two days a year, and said yes to every proposal put to it. Viewers are expressing the well-known criticism that it is all words and no action. Yet the learning process has been extraordinarily swift.

It has to be, for the Supreme Soviet is attempting to draft nothing less than the entire legal basis for a law-based state, where before the law was either ignored, or did not exist.

The process of attempting to create new laws is taking place against a background of furious public debate in the streets. Each attempt at economic reform – be it price liberalisation, cuts in state spending to trim the huge budget deficit, or the legalisation of forms of private enterprise – is met with an angry backlash from the likes of Mr Yarin, leader of the conservative United Workers' Front.

Now the Supreme Soviet is facing a big new challenge, before it has even come to terms with its old job: it has to learn to live with an executive president, with the power to veto its decisions, and somehow find ways of controlling the ever-present danger of untrammelled executive power.

There are already many problems in the system, with which the People's Deputies have to contend. For a start, the housing crisis in Moscow means they are all living hand to mouth in the cramped quarters of the Moskva Hotel – a stone's throw from the Kremlin, but scarcely congenial surroundings to recover from a day's labour in committee.

They have only the most rudimentary research facilities at their disposal – who needed any independent information in the past? Government ministries are ordered to answer their questions, but they still may take weeks to do so. There is a total staff of 600 in the Supreme Soviet secretariat – about one-fifth of the number working in the US Congress – attempting to service all 2,250 People's Deputies.

They can also claim up to Rbs300 a month for an aide – just about enough for a young researcher, or for a secretary, but not for both.

Perhaps more serious for a new parliament is the lack of legal draftsmen capable of writing laws which are unambiguous, and capable of clear interpretation in court. When the Supreme Soviet passed a law outlawing strikes in key industries last year, Mr Vadim Bakatin, the Minister of the Interior, openly admitted that it was unenforceable – because it failed to provide any penalties for specific offences.

In a classic understatement, Mr Veniamin Yakovlev, the new Minister of Justice, admitted last year that the problem with Soviet legislation was that it was all written "in the language of newspaper editorials." As for understanding what is happening in the parliament, and what precisely has been agreed, this will not be possible until the assembly sets up adequate printing facilities, to produce enough copies of draft laws, their proposed amendments, and verbatim accounts of each day's proceedings. All that is still far ahead.

In spite of the absence of a recognised multi-party system, the Supreme Soviet is already accommodating a variety of clear interest groups, and, in the shape of the Inter-Regional Group, something which looks suspiciously like an opposition.

The complication is that frequently the "opposition" is really on the side of Mr Gorbachev in pushing for more radical reform, and the "loyal" ranks of deputies are the ones most unhappy.

It was Mr Sergei Stankevich, an articulate young member of the Inter-Regional Group, who spelt out most clearly the concerns about establishing a powerful presidency for Mr Gorbachev – before the Supreme Soviet had really established itself as a strong democratic institution.

The Soviet leader himself was only persuaded of the need for an executive presidency in recent months, according to Mr Georgi Shakhnazarov, his political adviser. "Mr Gorbachev said a presidency was not in the Soviet tradition," he said. "Our tradition is more collegial."

The truth is that the Soviet legislators are writing and rewriting their constitution as they go along. The whole relationship between the directly elected Congress of Deputies, and the indirectly elected Supreme Soviet, may well be changed. There are many outside the official state and party structures who would argue that the whole system of soviets is incapable of accommodating genuine democracy.

"Mr Gorbachev is right. He never talks about democracy, only democratisation," says Ms Katya Podoltseva, a full-time activist in the Democratic Union campaigning for a western-style multi-party system. "We believe that the Soviet Union cannot come to democracy through the soviets."

THE COMMUNIST PARTY

Finally, the end of the Party

MR VYACHESLAV Shostakovsky, Rector of the Moscow Higher Party School, is a top party official – and a pretty wild radical in the ranks of the ruling Communist Party.

He is a founder member of the dissident Democratic Platform, which puts him politically on a par with the hugely popular communist maverick, Mr Boris Yeltsin.

Yet in the latest elections to the Russian parliament, Mr Shostakovsky was convinced that he was not going to win. The simple reason was that the voters would reject him because of his job.

"They will identify me with the party bureaucracy," he said. "Some of the voters are extremely negative about this."

The backlash against the ruling party has finally come into the open in every part of the Soviet Union, manifested not just in the secrecy of polling booths, but out on the streets.

In 1989, the great debate was whether the Communist Party would remain a monolithic ruling party, or become a genuinely pluralist party, with open disagreements within its ranks, and a federal structure to accommodate the rebellious non-Russian republics. In that way, it was argued, it might keep its effective monopoly of power.

In 1990, the question is far more about whether the party can survive at all, in what is now seen as the inevitable future of a multi-party system. At the very least, the debate has become one about when the party will split, not if it will do so.

"We don't really have any other forces today which are authoritative and influential," Mr Shostakovsky says. "Other structures are being formed, but they are still at a very initial stage. Yet in spite of its well-developed structure and mass membership, you cannot say that our party as such is very authoritative. That is the paradox."

In 1988, some 18,000 party members handed in their cards – only a tiny proportion of its 19m plus membership. Last year, the number increased tenfold, Mr Shostakovsky said, although the figures have yet to be published.

The point is that the Communist Party has lost its political authority, but does not know how to abandon its hold on power. Every significant position in the Soviet economy has been filled for years by a party appointee – and usually by one who has proved his or her credentials by blind loyalty, not ability. Every one of those members of the so-called *nomenclature* has a paramount reason to resist any dilution of party power.

Mr Nikita Khrushchev attempted to reform the *nomenclature* from above, and was eventually overthrown by it. Mr Mikhail Gorbachev is attempting to reform it by deliberately encouraging pressure from below. It is proving a far more effective strategy, but one with the ever-present danger that it will not stop with the *nomenclature*.

Ever since the 19th Communist Party conference in June 1988, it has been clear that Mr Gorbachev saw the need to remove the party from executive power. Whether he actually saw the need to break it completely is less clear.

"I'm not sure there was such a deep strategy," Mr Shostakovsky says. "The party was undergoing a euphoria of hope – hope for radical changes in the party itself." It was the disappointment of that hope which led to the creation of alternative "horizontal" structures within the Party – party clubs, direct links between primary party organisations, outside the full-time apparatus, which in turn has turned into the Democratic Platform. Many see that organisation as the nucleus of a future Social Democratic Party, divorced from the CPSU.

Mr Gorbachev himself only felt confident enough to tackle the party bureaucracy head on in February – after the wind of change had swept away the communist leaders across eastern Europe, and demonstrators threatened to do the same in the Soviet provinces. Yet what he has done is potentially devastating.

The decision of the central committee – against all its conservative instincts – to scrap Article Six of the constitution, enshrining the party monopoly of power, is the most important symbolic gesture. It frees not only alternative political movements to act openly as opposition forces, it also liberates dissidents in the party to think realistically about a split.

The simultaneous decision to establish an executive presidency is the one with the most dramatic practical consequences, for it frees Mr Gorbachev himself, and therefore the Soviet government, from real party control. The Politburo will exist no more, and he can choose his own cabinet instead – presumably without conservatives like Mr Yegor Ligachev.

So will the party survive, or will it split? It is far more likely that the radicals will break away than the conservatives. The latter are bound by blind party loyalty, until the bitter end. The former are desperate to distance themselves from the past.

For Mr Shostakovsky, the key will be the party's ability to transform its inner party structures, and internal democracy. That means scrapping democratic centralism – the dictatorship of the leadership – and most of the rigid party cell system. It means scrapping any privileged links with the Red Army and the KGB, the still-feared State Security Committee. And it even means positively encouraging the establishment of rival parties – by sharing party buildings with them, for example.

That is the programme the Democratic Platform is promoting, and Mr Shostakovsky does not seem to see much room for compromise.

"I think that if this programme is too long drawn out, there may not be a 29th party congress," he said.

Quentin Peel

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John Lloyd examines how the unity of the Soviet state is being torn apart by ethnic nationalism

A melting pot rapidly coming to the boil

"Ethnic sentiment and cohesion are the quickest catalysts of effective new association. Nationalism steps into the space vacated by ideocracy."

Ernest Gellner, Professor of Social Anthropology, Cambridge University, September 1989

IT IS impossible to describe the turmoil in the Soviet republics and among its nationalities in other than dramatic terms. In the past three years – popular fronts timorously began in 1987 – the unshakeable unity of the Soviet state, the project of creating *homo sovieticus*, the central grip by Party and ministries on the economies and societies of 15 republics and 100 ethnic groups have been weakened to the point where these concepts and powers can no longer either be invoked or used, except in extremis – as when Azeris and Armenians kill each other.

Consider:

■ The Baltic states of Estonia and Lithuania have *already*, in effect, declared themselves independent by renouncing the "agreements" which incorporated them in the Soviet Union 50 years ago; the third, Latvia, is likely to follow. Their nationalist leaders – they are very often communists, indeed, in Lithuania, the communist leadership *is* nationalist – speak now not about greater autonomy, a loosening of the central plan, a greater cultural diversity, but about Soviet troop withdrawals, separate currencies and a Baltic federation with the Scandinavian countries, Poland and (a united) Germany. The multi-party system is an established fact in all three. Indeed, these parties will have gone to the polls before any of their fellow parties in the East European countries, with the partial exception of Poland.

■ Of the three Transcaucus republics, two – Azerbaijan and Georgia – have in the past 12 months seen blood shed in their capital by Soviet troops. This has vastly increased the standing of the nationalist movement, split and faction ridden as it is in both republics. The tragic Armenians perhaps still need the Soviet guarantee of their borders as much as ever. But there, too, the clamour for the return of Nagorno Karabakh from Azerbaijan control after 70 years keeps their nationalist ball rolling while popular sentiment seizes on the inefficiency of the relief efforts for the survivors of the Armenian earthquake 15 months ago, and of the inability of the central power to stop Azeri massacres of Armenians.

■ Central Asian nationalism is beginning to show itself, in the Azeri and Tajik riots of January and February, and also in the relatively quiescent republics of Kazakhstan, Uzbekistan Kirgizia and Turkmenia. These are poor, rural republics. They have high rates of unemployment, and Communist parties which have lagged in democratising either themselves or the society. Now, their intelligentsia demand an end to sluggishness and the creation of distinctive identities. Less pacifically, agitation against Armenian refugees has been reported outside of Azerbaijan and Tajikistan and there are indications of a gathering anti-communist, perhaps Moslem-fundamentalist, movement.

■ In the Slav nations of Belorussia, Russia and Ukraine – making up more than 70 per cent of the Soviet population – slow but powerful movements are struggling to find expression. "Nationalism", says Mr Ivan Drach, leader of the Rukh (popular front) movement of the Ukraine, "is the euphoria of the last part of the 20th century. We are speaking of an independent sovereign personality in an independent Ukraine." His movement's young economists say the Ukraine, with its granary, could find a richer place on the world market than it currently commands on the Soviet one.

Russian nationalism is often assumed to be the most powerful of all, not just because it is that of the dominant nation but also because it has such powerful, pre-revolutionary roots – in the Orthodox Church, in the Russian imperial tradition, in the peasant culture and in that side of the Russian spirit which has been for centuries anti-western.

On one extreme, much highlighted by western and Soviet media, is Pamyat ("Memory"). On the streets it is capable of violence and is deeply anti-Semitic. Its leader, Mr Dmitri Vasilev, receives visitors in a vast flat hung with icons and Tsarobilia, wearing a military shirt with Tsarist emblems while protesting his willingness to fill a reconstituted Romanov – Vasilev – throne. Their fledgling stormtroopers may not be numerous but there is a wide body of opinion which thinks Russia has been suppressed and pillaged for decades, and that the process goes on still.

Mr Stanislav Kunyaev, editor of Nash Sovremennik, an increasingly popular journal of Russian culture and politics, says: "We got Marxism from the West, and that has been a catastrophe. We want to develop in a Russian way. If other republics want to leave – let them. But they will find that Russia has for centuries given them everything – its best people, its riches, its protection. This was not an empire like the British or the French."

Other Russians are not so insouciant about loss of empire. Last month, a group of Congress deputies formed a "Unity" association, with ethnic Russian deputies from the Baltic states in the fore, in order to "counter Russophobia" and maintain order.

It is hard to know how much of a constituency could be created in the awakened public mood for de-imperialisation. Russians have been used to moving about the expanding imperial area for centuries, in a way which the citizens of other imperial powers – even those which were contiguous, like the Turkish and Austro Hungarian, rather than far-flung, such as the British and French – did not.

There are 147m Russians in the other republics, and 25.2m citizens of other republics in Russia. Latvia is only just over half Latvian; Kazakhstan is only one third Kazhak.

The legislators will try to find a middle way. Some five bills on the nationalities issue appear before the Supreme Soviet in the current session, thrashed out by a drafting commission under Mr Georgi Tarazevich, a former President of Belorussia.

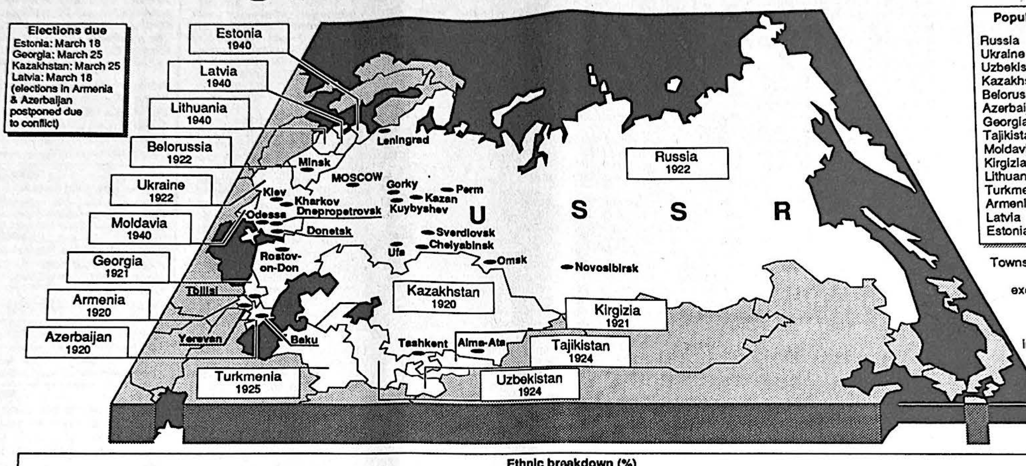
The most salient bill, that which provides a right of departure from the union, allows secession by referendum on a turnout of 75 per cent. The Supreme Soviet must ratify that, but a large vote in favour will, in practice, be impossible to override. Other bills allow greater economic autonomy and extend language and citizen rights. Mr Tarazevich says: "I don't know how many states will use this right. Perhaps it will concentrate their minds on a subject which is now not fully thought out."

This may be so. Mr William Smirnov, director of the political studies department of the prestigious Institute of State and Law in Moscow, says: "Our society avoided disintegration in the past because it was held together by fear. Now, at this stage, everyone wants to find something negative to say about the centre. But in two or three years time, when the constitutional changes take root, it may be quite different. Even in the Baltics, they are beginning to realise that, economically, it will be difficult to disentangle themselves. Indeed, the Central Asian republics may be harder to keep. These societies are really quite different from the rest of the Soviet Union."

The economic ties will be the hardest to break, as the east European countries, enmeshed in a Comecon net which they hate but which also provides some (dwindling) protection from the rigours of the world market, are now realising.

The Russian nationalists are right in this respect: Russia *has* provided and still *does* provide the necessary energy and raw materials for much of the rest of the Soviet Union. There is a perfectly good case to be made, by Russians, that they would be better off without many of the republics, particularly at a time when they are having to make costly concessions to keep them in the union.

But on their side, could these inefficient and sluggish economies really achieve any kind of independence? Or had they best throw in their lot with the ever receding prospect of a successful perestroika, and settle for the half loaf of autonomy? As the results emerge of the republican and local elections currently under way, the months ahead will see the start *of such a reckoning.*



Population 1989

	Million
Russia	147.4
Ukraine	51.7
Uzbekistan	19.9
Kazakhstan	16.5
Belorussia	10.2
Azerbaijan	7.0
Georgia	5.4
Tajikistan	5.1
Moldavia	4.3
Kirgizia	4.3
Lithuania	3.7
Turkmenia	3.5
Armenia	3.3
Latvia	2.7
Estonia	1.6

Towns shown are those with a population exceeding 1 million.

Dates in boxes indicate the year in which republic joined union.

Ethnic breakdown (%)

Russia: Russian 82.6; Tatar 3.6; Ukrainian 2.7; Chuvash 1.2; + more than 100 other nationalities.
Armenia: Armenian 89.7; Azeri 5.5; Russian 2.3; Kurd 1.7%.
Azerbaijan: Azeri 78.1; Russian 7.9; Armenian 7.9.
Belorussia: Belorussian 79.4; Russian 11.9; Polish 4.2; Ukrainian 2.4; Jewish 1.4.
Estonia: Estonian 64.7; Russian 27.9; Ukrainian 2.5; Belorussian 1.6; Finnish 1.2.
Georgia: Georgian 68.8; Armenian 9.0; Russian 7.4; Azeri 5.1; Ossetian 3.3; Abkhazian 1.7.
Kazakhstan: Russian 40.8; Kazakh 36.0; Ukrainian 6.1; Tatar 2.1.
Kirgizia: Kirghiz 40.7; Russian 22.0; Uzbek 10.3; Ukrainian 2.6; Tatar 1.7.
Latvia: Latvian 53.7; Rusian 32.8; Belorussian 4.5; Polish 2.5; Ukrainian 2.7.
Lithuania: Lithuanian 80.1; Russian 8.6; Polish 7.7; Belorussian 1.5.
Moldavia: Moldavian 63.9; Ukrainian 14.2; Russian 12.8; Gagauzi 3.5; Jewish 2.0; Bulgarian 2.0.
Tajikistan: Tajik 58.8; Uzbek 22.9; Russian 10.4; Tatar 2.1.
Turkmenia: Turkmen 68.4; Russian 12.6; Uzbek 8.5; Kazakh 2.9.
Ukraine: Ukrainian 73.6; Russian 21.1; Jewish 1.3; Belorussian 0.8; Moldavian 0.6; Polish 0.5.
Uzbekistan: Uzbek 68.7; Russian 10.8; Tatar 4.2; Kazakh 4.0; Tajik 3.9; Kara-Kalphak 1.9.

FT writers assess the moves for greater independence in (clockwise) Estonia, Georgia, Belorussia and Kazakhstan

The elephant and the mouse

AT ONE end of Europe the 12 members of the EC are talking about economic and monetary union. At the other end, Estonia – the smallest of the Soviet Union's 15 republics – plans to introduce its own currency, the kroon, perhaps by the end of this year.

Justifying this step, Mr Rein Otsason, president of Estonia's embryo central bank, the Bank of Estonia, says that a new currency is needed to free Estonia from the currency crisis of the Soviet Union. But he also sees the plan as a way of facilitating external trade.

What Mr Otsason plans is an independent currency, with the Bank of Estonia as a true central bank. A network of commercial banks is to be set up, while local branches of the main state banks will also become commercial banks within the new system.

Roubles that are held by people in Estonia in the Savings Bank of the Soviet Union on a date still to be determined will be exchanged for kroons. Cash will also be exchanged, up to a pre-specified limit.

Difficulties will arise in relation to the allocation of Soviet foreign assets and liabilities, but these can perhaps be resolved since they are essentially political. More fundamental, however, is the issue of convertibility, which is inescapable because a completely inconvertible currency is senseless for a republic with a population of only 1.6m.

For his part, Mr Otsason hopes for soft-currency settlement with the rest of the Soviet Union, pointing to the clause in the law on the economic independence of the Baltic republics, which states that "the rouble is to be used as the basis of inter-Republican settlements".

If the kroon were convertible into the rouble (but not convertible into hard currency) and securely backed by commodities as well, its price is likely to be driven up by people desperate for any haven of value. This pressure would both drain kroons from the Estonian economy and make Estonian goods uncompetitive within the Union. The Estonian authorities would need to limit holdings of the kroon in the rest of the Soviet Union, in which task they would require the active co-operation of Moscow.

None the less, a currency enjoying such limited convertibility into the rouble, but virtually no convertibility into foreign currency, might be workable in intra-Union commerce, though the uncertainty attendant on a floating exchange rate would have to be accepted.

If the kroon were convertible into hard currency, it could not be convertible into the rouble as well. Otherwise, its hard currency convertibility would be destroyed within an hour. In this case, the organisation of a decentralised system of trade, other than on the basis of settlement in hard currency, would not seem feasible.

Could Estonia hope to survive cut off from the Soviet Union by the hard currency wall? Many doubt it. But these doubters confuse self-government with self-sufficiency. As a low wage economy by European standards, Estonia could well prosper in the long term. Nevertheless, the process of adjustment would be agonising, in the absence of foreign assistance, since only 3 per cent of Estonian industrial production now goes outside the Soviet Union.

Estonia has a choice: it can either introduce a slightly better rouble – another currency that is inconvertible into foreign exchange – and so try to preserve its extensive exchange with the Soviet Union; or it can attempt to create a convertible currency, so cutting itself off from the Union.

In the short term at least, hard currency convertibility seems unrealistic, Furthermore, economic links to the Soviet Union cannot lightly be broken over night. Perhaps Moscow could be persuaded that accommodating the kroon within the rouble area is the only way of securing returns on past investments made in Estonia. Neither side will be happy with this compromise. It is easy to envisage Estonia outside in the cold in the near future, with independence, a new currency, its hopes – and little else.

Martin Wolf

April massacre hardens resolve

THERE can be few parts of the USSR where the yearning for maximum independence from Moscow is so strong as it is in Georgia, the southern republic whose spectacular mountains, lakes and Black Sea coast have nurtured a civilisation of extraordinary depth, wealth and antiquity.

This longing for freedom once vaguely felt and inchoate, hardened into a quiet, single-minded determination after the events of last April when troops wielding poison gas canisters and sharpened shovels massacred at least 21 peaceful demonstrators.

But at the same time, there can scarcely be another Soviet region with such a fine talent for observing the formalities of subservience to the Kremlin while quietly doing its own thing.

Thus billboards in Russian and the ancient script of Georgia nestle among the pine and cypress groves on the main road into Tbilisi, urging citizens to "fulfil the decisions" of the latest Party congress with a fervour that looks naive and quaint to the visitor to Moscow.

But in Tbilisi's richer neighbourhoods, with their elaborate balustrades of wood and wrought iron, residents seem unimpressed by the debates that are raging in the Moscow legislature over whether to establish in law the right to private property.

This is because in Georgia, a flourishing market in real estate exists already, with houses and flats regularly changing hands for several million roubles apiece.

"No one working with official data alone would find it easy to determine how this is possible in a city where workers in its many light industries earn no more than Rbs60 roubles a month, and practitioners of "skilled" professions such as engineering or medicine may well earn even less.

One reason for the amount of wealth in private hands is that in spite of collectivisation, enough of Georgia's rich orchards, vineyards and arable lands remain under private control to boost living standards in the cities to levels hard to imagine in the depressed Russian heartland.

To the indignation of many educated Georgians, one of the most powerful legends associated with their republic in the minds of other Soviet citizens is that of the fabulously rich Mafioso, friend and paymaster of corrupt officials, exploiter of shortages, trader across the Soviet Union in agricultural and other goods.

Mr Eduard Shevardnadze, the Soviet Foreign Minister who arouses ambiguous feelings among his Georgian compatriots, is credited with waging a bitter battle against some of the leading Mafia clans during his spell as party chief in Tbilisi, at considerable risk to his life.

Some local nationalists argue that the Mafia simply represent a distorted form of the legitimate capitalism that would have flourished in the absence of Soviet power, and will one day flourish under an independent Georgian government which regulates, but does not run, the economy.

It has to be said that Georgia – in contrast with the Baltic states – is hard to picture as a would-be Sweden, a super-efficient paragon of rationality and transparency in its economy and public life.

The Georgian model is altogether more southern: its 5m citizens are linked by a web of petty corruption and favour-swapping that entitles humblest of citizens to boast about his friends in official places. It is hard to see any form of independence changing this.

But at least in the short term, this Georgian way of public life is probably compatible with considerable skill in economic management – and certainly compatible with the forging of links, human and economic, with rest of the world, for which Georgians have a natural flair.

The Soviet-Austrian consortium which has already constructed a helicopter ski resort and is now building the first hotel in Tbilisi to meet international standards provides a spectacular example of what these links can mean in practical terms.

Given the Georgians' human and natural resources, their talent for observing form and ignoring substance, and their skill as middlemen, might they not do well out of President Mikhail Gorbachev's offer of "economic and political independence" within the USSR, if only as a transitional stage?

Or did the April 9 massacre, which remains a touchstone issue for radical Muscovite politicians and continues to provoke public arguments in the Politburo, show that the only appropriate response to Soviet authority is to campaign, peacefully but relentlessly, for its overthrow?

These are the terms of the discussion that is going on among ordinary Georgian citizens, and between the two sides in Georgia's semi-public debate: this pits the so-called "informal" groups – led by veteran dissidents and former political prisoners – against liberal members of the dwindling local Communist Party and the Popular Front.

Elections to the local Supreme Soviet on March 25 will provide an important test of the relative strength of the two sides: the 'liberal communists' and their allies are contesting for seats, while the informal groups are calling for a boycott.

The informal movement is weakened by its lack of access to printing presses and the state media; and also by the cool relations between the young leaders of the National Democratic Party and Mr Zviad Gamsakhurdia, head of the Helsinki Union and the grand old man of Georgian dissidents.

But Mr Gamsakhurdia and the NDP (which favours liberal democracy, with Orthodox Christianity as the state religion) agree in asserting that full, early independence is the only issue worth discussing.

Ms Irina Sarishvili, press secretary of the NDP and wife of its president Mr Georgi Chanturia, said shortly after the April 9 massacre that she believed in Georgian independence in the same desperate way that a mother believes her sick child will survive, whatever the doctors say.

Ten months and many street demonstrations later she is equally determined and less pessimistic: "the child's health is somewhat better" she believes

Henry Cleary

Slowly rumbling

IF ANY individual republic gives an idea of the vastness of the Soviet Union it is Kazakhstan. With a land area five times that of France, this huge territory straddles the emptiness of Central Asia from above the Gulf to New Delhi. North-south, it stretches from the Siberian steppe to the foothills of the Himalayas.

It is a republic at once so deserted that it was chosen for the Semipalatinsk underground nuclear testing ground, and so colourful that Alma Ata, the state capital, ranks as one of the Soviet Union's most spectacular cities, nestling against a panorama of jagged snowclad peaks.

Kazakhstan is not a republic that has hit the headlines with stories of nationalist unrest or independent urges. It is too diffuse for that: there are nearly 100 different nationalities with the Kazakhs themselves accounting for barely 40 per cent. But Kazakhstan has been rumbling none the less.

The focus has been the republic's huge natural wealth: coal, minerals, oil and agriculture all of them developed on a grand scale through the Soviet central planning system.

Local resentment at what is seen as the plundering of the republic by its Russian neighbours has been mounting. The temperature increased last year with the replacement of the (Russian) party secretary by a bright and outspoken Kazakh economist, Mr Nursultan Nazarbaev. Although viewed very much as a Gorbachev man, he has called for greater local economic autonomy for the Kazakh republic.

Mr Nazarbaev has been careful to temper these calls with assertions that Kazakhstan intends to remain in the Union. But he has struck a clear chord for the republic's 16m people whose frustrations with food shortages and often appalling living conditions have spilt over into strikes and riots.

"We produce wool which we sell to the Russian republic for Rbs5 a kilo, and they turn it into a suit which sells for Rbs200," says Mr Feodor Ignatov, the editor of the local party newspaper, Kazakhstanskaya Pravda. "That's what makes people cross."

To the extent that there is nationalism in Kazakhstan, it found its strongest expression last year in a new law which made Kazakh the official state language. But implementation has had to be phased in over several decades because of shortages of Kazakh teachers.

There is also a strong local environmental movement which has political overtones, and has focused particularly on the desiccation of the Aral Sea.

But perhaps the most astonishing sign of popular feeling to have emerged from Kazakhstan is the so-called Nevada Movement. This is an alliance against nuclear testing focused on Semipalatinsk whose objectives and vociferousness would have been inconceivable in pre-Gorbachev days. Such is the strength of feeling that both Kazakhstan's Communist Party and the republic's parliament now support the closure of Semipalatinsk. Moscow has responded that nuclear tests are vital to national security. But it has promised to heed local concerns.

David Lascelles

Tide is turning

THE pressures of economic fragmentation are rippling, as yet gently, through the Belorussian republic.

In January the republic began an experiment with regional cost-accounting which gives it limited independence from Moscow. The experiment could be an important test case of whether Moscow can design an economic system capable of both accommodating and moderating regional demands for full economic independence.

Belorussia did not suffer as badly as many other republics from the years of stagnation during the Brezhnev era. In 1975 its national income was 15 per cent below the average. By this year it will be 15 per cent above the average.

The improvement in economic performance has been sponsored by a conservative, technocratic Communist Party leadership, which has allowed economic innovations to flower beneath its wing. Belorussia was one of the places President Mikhail Gorbachev looked to when framing his economic policies in 1985-86.

Large parts of Belorussia have been turned into wastelands by the aftermath of the Chernobyl disaster in 1986. The increasingly powerful Belorussian Ecological Union, which plans to become a fully fledged party, says that more than 300,000 people should be evacuated from contaminated areas.

The union, which sprang into life last year with four mass rallies in Minsk, wants the Chernobyl clear-up made the republic's top priority, according to Professor Yevgeni Petrayaev, its vice president.

The republic's supreme soviet has adopted a six-year Rbs17bn programme. But Professor Petrayaev estimates the full cost of a proper programme would be at least $140bn.

Belorussia is one of the main manufacturing areas in the USSR. It produces a sixth of the USSR's tractors, and 80 per cent of its televisions and refrigerators are exported to the rest of USSR and a third of all furniture and footwear.

Mr Georgi Badei, deputy chairman of the Belorussian state planning commission, admits the republic's administration is under pressure to keep more of the consumer goods output for the republic's consumers and export less to the rest of the union.

Republican cost accounting – or self guiding as the Belorussian authorities like to call it – is meant to address and control these growing strains in the republic's relations with the rest of the union.

Mr Badei believes more radical economic policies will develop. Regional cost accounting is likely to mean Belorussian enterprises will have complete flexibility over pay and new taxes, for instance on pollution, may be introduced.

Professor Petrayaev says regional cost accounting should lead to a more active republican approach to the environment and industrial policy.

Mr Yevgeni Onegin, director of Planar, a Minsk machine tool plant, voiced the main concern of business: "This will just be a transfer of ministries from Moscow to Minsk, regional planning and control rather than central planning and control."

Charles Leadbeater

FOREIGN AFFAIRS

Ian Davidson examines Mr Gorbachev's efforts to realign the basis of East-West relations

From confrontation to partnership

BY COMMON consent, the most remarkable of all the achievements of the wave of reforms introduced by President Mikhail Gorbachev during the past five years lie in the field of foreign affairs. His pressure for far-reaching nuclear and conventional arms reductions is being rewarded by rapid progress in the Geneva and Vienna negotiations, while in the eyes of the rest of the world his diplomacy of compromise and sweet reason is transforming the reputation and influence of the Soviet Union out of all recognition.

The Soviet Union has always been an ideological power, in which ideology and policy were inseparable, and in which the ideology took as its starting point an inevitable hostility between communism and capitalism. As a matter of principle, that has now changed. It is Mr Gorbachev's aim to shift the Soviet relationship with the West from confrontation to partnership, with the Soviet Union taking its place in the world community as a country like any other.

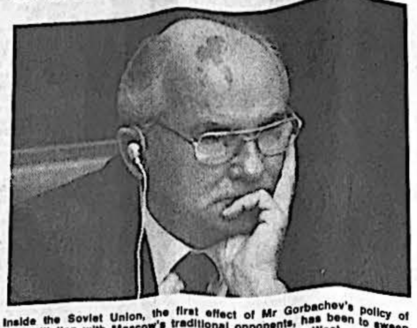
In reality, however, the sheer size of the Soviet Union is living proof that it has not been, and is not now, a country like any other, since it attests to a scale of geo-strategic expansion up until a very recent past, which culminated in the creation of the world's last colonial empire. Many years will doubtless have to pass before the legacy, first of Tsarist autocracy, then of Stalin and the Stalinist system of government, can be effaced: and before Mr Gorbachev's apparent aim, of a stable pluralistic democracy with a technologically advanced economy, can be realised.

Inside the Soviet Union, the first effect of Mr Gorbachev's policy of reconciliation with the traditional opponents of the Soviet Union, has been to sweep away the long-standing fears of nuclear war with the West, which had been so assiduously stoked up by President Ronald Reagan in the early 1980s, and just as assiduously denounced by Soviet leaders. Moreover, Mr Gorbachev's increasingly successful public relations campaign abroad helped, at least initially, to buttress his reputation at home. But the second effect of his policy of glasnost and reform has been a blow to national confidence in the virtues of the Soviet Union.

In two respects there is a direct parallel between the effects of Mr Gorbachev's reforms of domestic and foreign policy. In the first place, the old model has been discarded before any reliable replacement has been articulated: the foreign policy of superpower dialectic and ideological confrontation has been thrown out before there is a working agreement on a less highly-charged alternative foreign policy.

The second parallel is more disconcerting, and it is the widespread expression among Moscow intellectuals of disillusionment and disgust with the past. Just as it is now customary to denigrate the shortcomings of the economy and the failures of the political system, so it has become a mark of sophistication to dismiss with disdain all the previous geo-political claims of the Soviet Union in the world.

At the level of idle conversation, it is disconcertingly common to hear educated Russians mock the grotesque and overblown pretensions of their country, describing it as "a Burkina Faso with nuclear weapons". At the level of serious discussion with Soviet officials and analysts, it is equally disconcerting to hear the Soviet Union described as "a former superpower."



Inside the Soviet Union, the first effect of Mr Gorbachev's policy of reconciliation with Moscow's traditional opponents, has been to sweep away the long-standing fears of nuclear war with the West

In purely rational terms, a profound re-evaluation of the Soviet record in the world was of course long overdue. The political and economic balance sheet of Soviet backing for the left-wing regimes in Cuba, Vietnam, North Korea, Angola, Mozambique, Libya, Syria, Ethiopia and finally Afghanistan, is universally unimpressive.

The record of Soviet policies in eastern Europe is even more dismal, considering that some of these countries are relatively less developed now than they were before the imposition of communist rule.

Soviet officials appear to believe that Soviet public opinion accepts comparatively philosophically the wave of revolutions in the other east European countries, in spite of the implied "loss" of the geo-strategic gains of the Second World War.

But the prospective "loss" of East Germany is an altogether more sensitive issue. Soviet officials and analysts disclaim any rational grounds for fearing that a reunited Germany could possibly constitute a real military threat in the near future to a nuclear power like the Soviet Union; but they assert that popular opinion in the Soviet Union is still allergic to the spectre of German militarism, and is still not reconciled to German reunification, because it was the division of Germany which was to compensate the Soviet Union for the loss of 20m dead in the struggle with the Nazi regime, and to insure against another such war.

The ordinary Soviet citizens may previously have felt compensated for the hardship of daily life, by the knowledge that the Soviet Union had played a leading and heroic role in the defeat of Nazi Germany and pride that it had since become a nuclear superpower.

The consequence of Mr Gorbachev's new foreign policy, with its search for a broadly-based reconciliation with the West, is that the terms of the Soviet Union's external relations have been radically altered in at least three important ways.

First, the relationship between the superpowers has become a less dominating feature of the international scene. In the pre-Gorbachev era, when conditions of the East-West relationship oscillated between confrontation and wary detente, the axis of the relationship tended to pass through the two opposing alliances, and even more through the two opposing superpowers: the alliances were compelled to unite behind their leaders, and their leaders became the protagonists for the two sides. In the new era of declining perceptions of military threat, in contrast, the alliances have ceased to be the central interface for the East-West relationship, and the essential dialogue does not pass exclusively between the superpowers.

The second innovation, by the same token, is that nuclear weapons have become a less important currency in the East-West relationship during the Gorbachev era. In the past, because of the underlying assumptions of their military confrontation, the highs and the lows of the US-Soviet relationship were essentially defined in terms of nuclear weapons.

One of the dominant characteristics of the Gorbachev era, is that a far-reaching reduction in East-West tension has been accompanied, and indeed partly brought about, by spectacular progress towards the first-ever deep cuts in nuclear weapons. Paradoxically, however, nuclear weapons are becoming less central to the East-West relationship, because the relationship is itself becoming less confrontational and less military.

Before the end of this year, the two superpowers should have concluded a Start treaty which will cut strategic nuclear arsenals by a notional 50 per cent. The *military* significance of such a cut will be marginal, considering the enormous size of the arsenals which they will still retain; but most of the *political* significance will have been achieved early on, in the confidence-building expectation of such a deal.

Conversely, nuclear weapons will be a less dominant item on the agenda, since the agenda itself has been enormously enlarged, by the choice of the Soviets, who have deliberately sought to expand it to include many previously taboo subjects, including human rights. Moreover, even a very large reduction in strategic nuclear weapons will be far less significant in security terms for Europe, than the prospective Vienna agreement, which will eliminate Soviet superiority in conventional forces in such conditions of verifiability as virtually to eliminate the danger of surprise attack.

The third innovation, is that the revolutions in eastern Europe have rewritten the Soviet Union's foreign policy priorities, on a scale and at a speed that no one could have imagined even as recently as a year ago. Whether or not this was Mr Gorbachev's intention – it seems unlikely – the changes precipitated by perestroika and glasnost in eastern Europe, have re-opened all the long-suppressed questions of Europe's political geography, and have put in doubt many of the geostrategic assumptions under-pinning the Soviet Union's status as a superpower.

It is a safe bet, therefore, that the future of Europe, East and West, will dominate the Soviet Union's foreign policy preoccupations for many years to come.

The main question which seems to be unresolved in Moscow, is what sort of strategic security system to aim for. Three main ideas appear to crop up in Moscow talk: a resuscitation of the old dream of collective and demilitarised security in Europe; some form of condominium derived from the Four Powers Agreements; or a modified system of strategic balance between East and West.

The appeal of this strategic balance, in which Germany is contained within the European Community and Nato, but security is guaranteed as much through verified disarmament as through armaments, is that it may be the only option which is attainable within the foreseeable future.

At all events, one of the striking features of Moscow talk is the readiness of some foreign policy specialists to recognise that the European Community has political as well as economic strengths which may well prove to be a factor of stability in an unstable world.

EASTERN EUROPE

Trouble in the backyard

IN THE past five years the Soviet Foreign Ministry has enhanced its reputation: it was seen to be promoting peace and friendship abroad, and this brought prestige to the Soviet Union. It is less popular now but that is largely because of eastern Europe.

"There are people in this ministry," says Mr Alexei Nekiphorov, head of the East European section in the Foreign Ministry, "especially those who are concerned with security and military matters, who would see what has happened as the destruction of the Warsaw Pact, or at least its diminution."

This is not just confined to the elite. Mr Andrei Grachov, deputy head of the international department at the Communist Party Central Committee, says that "it is difficult now for Mr Eduard Shevardnadze, the Foreign Minister, to persuade people that all is well in eastern Europe. They say we have lost what we gained in the war, especially when it comes to East Germany."

It is here, in his own back garden, where President Mikhail Gorbachev faces a range of foreign policy issues which his harder line opponents will insist become part of the stuff of domestic politicking, on the theme of "the USSR's (declining) place in the world".

Already, in a speech to the Central Committee plenum a month ago, Mr Ygor Ligachev warned of a "Germany with vast economic and military potential" that was "looming on the horizon". Huge efforts had to be made to cut short any attempts to revise the post-war borders, and "prevent a post-war Munich," he added. If Mr Gorbachev is to avoid being cast as a Soviet Chamberlain, he must – in Mr Grachov's words – "get confirmation of the fact that he is not selling out the security of his country."

In short, he needs US and western European assistance in *not* looking like a patsy – a line which gives some vindication to the view taken by Mrs Margaret Thatcher, the UK Prime Minister, who argues that too rapid endorsement of a united Germany would put too much pressure on the Soviet Union.

This is the view that sees eastern Europe as a threat: but there is also a view that sees it as an opportunity, or at least as an example. "If the eastern European economies, especially Poland, can attain success, then that will greatly help our reforms," says Mr Nekiphorov.

In Warsaw, Dr Arthur Hajnicz, foreign policy adviser to the Polish Prime Minister, agrees. "Of course, if we fail, it will be the worse for them too," he says. Dr Yuri Knazev, head of a section in the Institute of Economics of the World Socialist System, divides the east European countries into "a group which will go towards the West as fast as possible, a group which might manage to achieve a democratic socialist alternative and a group which makes some cosmetic changes but continues as before. The Soviet Union, I fear, may be in the latter."

In the responses of policy makers and analysts to the events in east European, there is evident a strain of pessimism which derives not so much from their dislike of what has happened *there*, but their fears of what will or will not happen in the Soviet Union.

There is, at present, little hope that the economic reforms, stalled more or less explicitly, can work. It is thus assumed that the eastern European countries will as fast as possible strain away from the ailing giant, now that they no longer have to protest unshakeable friendship.

But can they? It is becoming clearer, as work begins on creating institutions to sustain these new regimes, that their freedom for manoeuvre is *limited. First, their fears over* their borders – especially with Germany – mean that they

'There are people in the Foreign Ministry who would see what has happened as the destruction of the Warsaw Pact'

will continue to look to the Warsaw Pact as a guarantor of the post-war settlement, from which they all did more or less well. Second, their membership of the Council for Mutual Economic Assistance (Comecon), though now seen as something which confirms and deepens their technical and commercial backwardness, is still essential to avoid their more rapid collapse since there are no other other markets in which they can compete effectively.

Dr Alexander Nekipolov is deputy director of the Institute of Economics of the World Socialist System. Like his colleague, Dr Knazev, he is a pessimist on the present prospects of perestroika – but is harshly realistic about Comecon. For if the events of eastern Europe are a threat, and their experiments a hope, then the dissolution of Comecon is a windfall.

Mr Nekipolov confirms that estimates have been made which show that the Soviet Union would benefit by some $10bn from the transfer of Comecon trade into hard currency – a measure the Comecon congress in Sofia in January agreed would proceed in stages. *The Soviet Union will be able to sell its raw materials* on the world market and also shop on that market for capital and other goods of better quality, but perhaps at no higher price than Comecon can provide.

"Our enterprises already have $2bn in hard currency they can spend freely, and little of it is spent in Comecon countries," says Mr Nekipolov. "So you see what effect liberalising trade entirely would have."

This is dramatic – the more so since the more advanced the country, the more it depends on the Soviet market. Forty per cent of all East German production and 70 per cent of all Czechoslovak engineering exports are destined for the USSR. Figures first produced for the US-based PlanEcon group, and verified by the Institute of Economics of the World Socialist System, show further that between 1970-84, each Soviet citizen paid $4,000 to East Germany in subsidy to its industry – an index of how far the prices of East German and other Comecon products exceeded world prices and of how much East German living standards depended on the poor Soviet consumer. "For us, economically, Comecon was a loss," says Mr Nekipolov. "But politically it was a gain"

It is this perception on the part of some of the Soviet governing class – shared with the new east European governments – that Soviet domination since the war has twisted the economies and societies to such an extent that *some reparation must be made which is now gaining ground.*

"I don't mean reparation in the sense of payments," says Mr Nekipolov, "but in the sense of letting them down gradually. This will have to be negotiated. But we will agree a gradual phasing in of hard currency, and in that time we hope all of us will make something of the transition to the world economy."

The Soviet Union and eastern Europe have passed from a stage of being yoked together in formal fraternity to one where the resentments and hostilities now enjoy free play – the more so since the ruling elites in at least Poland and Czechoslovakia have been against the Soviet system since their inceptions as opposition movements.

Yet even as there continues to be anti-Soviet demonstrations, and as the newly-turned democratic communists seek to distance themselves from the country they once called Motherland, so the sober thought strikes these countries' leaderships again and again: can we leave Mother yet, even when she will no longer stop us from going?

John Lloyd

ASIA

Frosty relations begin to thaw

SOVIET relations with Asia have gone through nothing like the shocks experienced on the Soviet Union's western front in the past year. Yet with the notable exception of Japan, where there is an outstanding territorial dispute, in Asia too there has been a broad easing of tension.

The centrepiece of this took place last May when President Mikhail Gorbachev made an historic visit to the Chinese capital, sweeping away 30 years of deep mutual suspicion and animosity between the two communist giants.

This process of normalisation got off to a shaky start when hundreds of thousands of Chinese demonstrators jammed the streets and hailed Mr Gorbachev as a symbol of democratic reform, to the embarrassment of both the Soviet delegation and the Chinese authorities.

The Chinese remain deeply suspicious of Mr Gorbachev's political reforms at home, and worried by the upheaval in eastern Europe and Mr Gorbachev's response to it. The Soviets were plainly shocked when the Chinese army brutally crushed the peaceful, mass protest in Tiananmen Square which gathered force throughout Mr Gorbachev's visit.

Yet the depth of Chinese and Soviet reconciliation was proven when neither side allowed these differences to interfere with a broad process of improved relations.

"There was a principle that we are quite different, but that differences of opinion should not interfere with our relationship," says Mr Mikhail Titarenko, director of the Institute of Far Eastern Studies, which advises the government on Asian affairs. "We are not going to enforce our views on them."

China and the Soviet Union have *not* become allies, nor is this likely. They continue to disagree on many regional and bilateral issues.

Yet since the Gorbachev visit, the two sides have exchanged more than 100 delegations at the vice ministerial or higher level. Several previously off-limits areas, such as Communist Youth League or direct Party-to-Party relations, have resumed.

Regional, cross-border, economic exchanges have mushroomed, particularly between the Soviet central Asian republics and the Chinese province of Xinjiang, and between Manchuria and the Soviet Far East.

There are now 24 operating joint ventures ranging from a vacuum bottle plant at Alma Ata to a joint venture restaurant, the Harbin, in Khabarovsk, with many more under discussion.

Some 10,000 Chinese labourers (15,000 according to Chinese statistics) are currently working inside the Soviet Union on various construction projects. Migrant Chinese farm workers are active in the Novosibirsk area in Western Siberia.

None the less the economic relationship is an awkward one, because of a lack of convertible currency, and the two-way trade last year was only Rbs2bn, roughly 10 per cent more than in 1988.

Chinese labourers are paid in roubles, and must take their pay home in Soviet commodities – refrigerators or televisions – that are often in short supply in the Soviet Union itself.

Local trade is constrained by the need for barter, with values negotiated in terms of Swiss francs. Tourism is also growing on a strictly matched basis in which equal sized groups pass the border on subsequent days, each side paying for the other's expenses in local currency. The two sides will this year consider whether to move the trade to a hard currency basis, although there are fears this could lead to a drop in trade volumes.

Telecommunications links between the two countries are terrible, and transportation links poor, although this is being steadily improved.

Flights have begun between Khabarovsk and Harbin, and direct flights between Moscow and Shanghai will start this year. Consulates are to be opened in Khabarovsk and Shenyang. A rail link between Urumqi and Alma Ata is scheduled to be opened in 1992, built largely with Soviet finance. More steamer routes along the Amur river will link Soviet and Chinese cities.

Visa procedures have been simplified, with visas eliminated for business travel. Eight new border-crossing points are being opened up, to add to the existing 15.

Perhaps most impressive of all, delegations at the "expert" level, consisting of five military officers and five diplomats, sat down for the first time in Moscow last November, to discuss how to build confidence along the border. The discussions continued in Peking in mid-February.

Soviet diplomats believe the improved atmosphere had led the way towards a possible settlement of the Cambodia conflict, in which all parties are now actively meeting. China and the Soviet Union back opposite sides of the conflict but have together played a key role in fostering possible UN involvement in a settlement.

With Soviet troops stationed in Cam Rahn Bay, Vietnam, pulling out, the path has been cleared for further improvements in ties with South-east Asian nations, where Mr Nikolai Ryzhkov, the Soviet Prime Minister, has recently made a tour.

The Soviets have also been stepping up trade ties with South Korea. Although politically they stand firmly behind their North Korean ally, they would plainly like to see more dialogue and further easing of tension on the peninsula.

This leaves Japan as the outstanding deadlock. Mr Ryzhkov's recent suggestion that Tokyo and Moscow shelve their territorial dispute in the interests of improving political and economic relations was promptly rejected by the Japanese. It is clear that no Japanese government can afford politically to give up claim to the four Kurile Islands which Soviet troops occupied after the Second World War.

Officially the Soviet stance has not budged – that there is no territorial dispute to be discussed. However Mr Gennadi Gerasimov, the Soviet foreign ministry spokesman, recently created an odd twist to this issue when he said that some Soviets were arguing in favour of giving back these small islands (which have a strategic importance because they span ice-free winter sea lanes to the naval port of Vladivostock).

Should that happen Soviet relations in Asia, which have been a source of frustration for many years, will have been transformed completely.

Steven Butler

DISARMAMENT

Farewell to arms

EVER SINCE President Mikhail Gorbachev came to power five years ago, his "new political thinking" in foreign policy has been driven by the triple objective of détente, de-ideologisation and disarmament. The achievements so far are more profound than those of earlier periods of détente, and look like having far more durable results.

Under all previous Soviet leaders, superpower diplomacy had taken the form of an absolutely predictable action-reaction dance: the US would make proposals, and the Soviet Union would react, often negatively. Under the Gorbachev regime, that pattern has been reversed.

After the East-West freeze induced by the Euro-missile crisis of 1983, nuclear arms control talks resumed in 1985, coincidently the day after Mr Gorbachev came to power. At that time the US was proposing a one-third cut in strategic nuclear weapons, and the Soviet Union was responding more modestly with a proposal for a 25 per cent cut. But at his first summit meeting with US President Ronald Reagan in Geneva that autumn, Mr Gorbachev was already raising the stakes by calling for a nominal 50 per cent reduction, which has since become the official target for the Strategic Arms Reduction Talks in Geneva.

And so it has continued since then. At the next US-Soviet summit meeting in Reykjavik the following year, Mr Gorbachev almost succeeded in sweeping Mr Reagan off his feet, with an apparent proposal for the elimination of all nuclear ballistic missiles.

In December 1987, the Soviet leadership concluded what its predecessors had adamantly refused, an agreement to eliminate all US and Soviet Intermediate Range Missiles (INF) in Europe. And there are good prospects that the Start negotiations will produce big cuts in the long-range nuclear weapons of the superpowers.

The achievements so far are more profound than those of earlier periods of détente, and look like having far more durable results

In purely military terms, this Start agreement will not make much difference, since both sides will continue to have colossal overkill in strategic nuclear weapons. In contrast, the conventional military balance between East and West is likely to be fundamentally altered by the negotiations on Conventional Forces in Europe (CFE) now under way in Vienna. With luck, these CFE talks should produce a treaty for endorsement at this year's Helsinki summit, which will bring about, for the first time in 40 years, a true military equilibrium in Europe.

In addition, both Moscow and Washington have been hurrying ahead of the Vienna process. In December 1988, at the United Nations, Mr Gorbachev announced a unilateral reduction in the Soviet Union's armed forces of 500,000 men. In 1989 President Bush responded with two successive proposals to reduce US and Soviet troop levels in Central Europe.

The underlying message of these successive negotiating moves has by now become virtually impossible to deny: the Soviet Union of Mr Gorbachev believes it is possible to abandon a foreign policy based primarily on the assumption of conflict and on the threat of military force. What is less easy to fathom, is where this leads in strategic terms.

Moscow regularly insists on the need to maintain the strategic balance in Europe, and the equilibrium between Nato and the Warsaw Pact. Yet at the same time, the Soviet leadership repeatedly appeals to the quite different idea, of some kind of pan-European security order, no doubt derived from the provisions of the Helsinki process, under the evocative name of the Common European Home.

Earlier this year, Moscow reiterated its intention to withdraw all its troops from eastern Europe by 1995-96, and said that it expected to negotiate an even earlier time-table for withdrawal from Czechoslovakia and Hungary. Such a withdrawal is no doubt a rational response to the revolutions in eastern Europe, which have undermined the credibility of the Warsaw Pact; some analysts in Moscow argue that the only chance for salvaging the Pact lies in military withdrawal, and even then its main role may be political dialogue between the countries of eastern Europe and the Soviet Union.

These unanswered questions should not obscure the most important fact, that Mr Gorbachev is presiding over the end of a long period of Cold War, and the beginning of a new period of effective arms control and arms reduction.

Ian Davidson

EUROPEAN COMMUNITY

A model for Moscow

"EUROPE is a new centre of power," said Mr Alexei Arbatov, one of the Soviet Union's leading young foreign policy experts. "Western Europe will become more important in Nato, since some US withdrawal is inevitable; it may even become the major partner in Nato.

"The European Community," he went on, "has a very strong political role to play, because economic factors are now becoming predominant. I would not be surprised if there were a supranational government in western Europe 10 years after the Single Market of 1992; or even in the whole of Europe, excluding the Soviet Union. But the EC is not an opponent of the Soviet Union, nor a threat to the Soviet Union, unless it becomes the core of a new military alliance."

Sentiments like these are a testimony to the dramatic effects of President Mikhail Gorbachev's policy of perestroika on foreign policy perceptions in the Soviet Union. Until recently, the EC and other manifestations of European integration were officially denigrated in Moscow as a hostile manifestation of the Cold War.

A less caricatural picture of the movement towards economic and political integration in western Europe has at various times occasionally broken through the official line in the Soviet Union in the past 40 years. But Soviet analysts did not systematically start to take a more realistic assessment, until Mr Gorbachev introduced his "new political thinking" on foreign policy, uncontaminated by the ideology of communism and the Cold War.

Officials and academics in Moscow appear to see more good in the EC than does Mrs Margaret Thatcher

Today in Moscow it is common to hear officials and academics express positive views of the EC; some of them even appear to see more good in the EC than does Mrs Margaret Thatcher.

Professor Vladimir Baranovsky, of the IMEMO Institute, believes there are three main strands in the Soviet reassessment of the EC. First, there is a growing recognition that economic integration is not an offensive of the West European monopolies against the working class, but a process of social accommodation which can be beneficial for large parts of the population. Second, the new attempt to see the world in inter-dependent terms, means that the Community can become a partner rather than an enemy. Third, the necessity of making a more realistic assessment of the Soviet Union's own economic failures, increases the incentive for learning from others, including the EC.

Thus Mr Stanislav Kondrashev a leading commentator at Izvestia: "Many people now see that the western European countries tried to solve, and in fact have solved, very important economic problems, step by step, with great efforts. Our efforts with other Socialist countries are not at all successful. But we will find it easier to build new, more effective forms of economic relations with our neighbours, if we build constructive relations with western countries."

This fresh look at the nature of the EC is leading to a sharp reassessment of its political as much as of its economic significance. "Since 1985," says Mr Sergei Karaganov of the Europe Institute in Moscow, "our analysts have said we should get rid of 'America-first-ism' in our foreign policy priorities. Now we give equal priority to America and to Europe. Western Europe's influence on US policy has mostly been positive. A stronger EC will be a factor for stability in Europe, though Germany may have a dominating influence on it."

The shift in Soviet attitudes towards European integration has been followed by closer diplomatic links. Last year the Soviet Union, like Comecon, signed framework trade agreements with the Community; and the Soviet Union also secured Special Guest Status at the parliamentary assembly of the 23-nation Council of Europe, though not to vote.

The most interesting feature of the new thinking is that some Soviet analysts are starting to look to the EC as a possible model, not just for revitalising economic and political relationships within Comecon, but even for reform inside the Soviet Union.

Ian Davidson

MILITARY

The bitter climate of cuts

A SENSE of disorientation and alarm is spreading within the Soviet military elite. The allegiance of Soviet officers to the Party, to the socialist fatherland and to internationalist duties within the Warsaw Pact and further afield is ingrained in military training and values. But this world-view is fast losing its relevance, as the role of the Soviet armed forces is challenged by the collapse of military certainties.

Political upheaval in eastern Europe has paved the way for the rapid retreat of the Red Army from Czechoslovakia, Hungary and Poland. The break-up of the Warsaw Pact military apparatus is under way and a powerful united Germany looms.

The Soviet military budget is vulnerable to a climate of cuts and much of the country's conventional military strength is destined to be traded away in highly asymmetrical arms agreements with the West. Within the USSR Soviet forces are committed to maintain central control in regions plagued by intra ethnic strife. Even the economic and technological promise of perestroika which raised the prospect of more efficient and better equipped if smaller Soviet armed forces in the future, is now overshadowed by gloomy forecasts.

Red Army commanders may reasonably conclude that the Soviet military environment in 1990 is driven by trends increasingly beyond Moscow's control. Their worries are frequently expressed in sharp debutes in military circles, leading at times to polarised views.

No doubt the Soviet High Command is dismayed by the pace at which Warsaw Pact unity has collapsed. The view that the strategic gains of the USSR were won at the cost of millions of Soviet wartime dead, is still ingrained in their military thinking.

Soviet military leaders are committed in principle to pulling back at least 370,000 of their forces from eastern Europe and sharply reducing their force levels west of the Urals under the draft treaty on Conventional Forces in Europe (CFE).

An overall fall in the Soviet military budget of some of 14 per cent over the next couple of years has been promised including a cut of 8.3 per cent in 1990 (said to be from Rbs77.3bn to Rbs70.9bn) and 19.20 per cent cut in arms production. The military command can swallow these cuts in the context of East-West disarmament but so long as the economic and technological basis for the weapons systems of the future is laid. With this goal in mind they can support perestroika and accept that more defence industries should be given over to civilian production.

Military leaders are also agitated over radical proposals that the current sprawling cadre-conscript army be transformed into a new organisation based on the principles of a professional and/or territorial force. Officers favouring such a transition believe that it would free manpower and resources for the civilian economy and help ease the current alienation between the Soviet military and civilian populations. Yet for Mr Dmitri Yazov, the Defence Minister, such a professional army would be too costly and unable to provide a sufficient reserve for long-term military actions.

Military leaders have found the idea of creating territorial formations based on national residence especially controversial, linked as it is to a larger nationalist agenda in the Baltic and other volatile republics. This is an explosive issue and it challenges the traditional Soviet view of the armed forces as an integrating force for various Soviet nationalities. The Soviet High command has reluctantly yielded some ground to Baltic and Georgian demands that recruits be allowed to serve in or near their home republics in an attempt to head off growing anti-military sentiment.

Over the past year the esteem of military service has been undermined by an upsurge in press criticism of the brutalising of recruits, drunkenness and corruption, which conveys a bleak picture of military life. Many officers find such criticism repugnant and have declared it ill-informed, unpatriotic and malevolent. This reaction reflects their deep unease about social trends under perestroika.

Special attention has focused on the difficulties in socially and economically integrating the 500,000 troops to be reduced unilaterally under Mr Gorbachev's December 1988 announcement. Up to 100,000 former officers will lose this status and ready access to accommodation. This threatens to create a large pool of disaffected demobilised officers. The capacity of the economy to readily absorb such an influx of labour is uncertain.

The use of Soviet troops to quell internal ethnic and nationalist strife has dealt a damaging blow to military prestige. Moscow's decision to use regular army forces to smash into the Azerbaijani capital Baku in January only followed the failure of local KGB forces and Ministry of the Interior troops to regain central control in Azerbaijan, and it was undoubtedly taken with the greatest of reluctance.

The political cohesiveness of the armed forces has traditionally been entrusted to Communist Party organs, in particular the Main Political Administration (MPA) of the army and navy. But a Central Committee decision last month to abandon the principle of the leading role of the Party forces a reappraisal of Party organisations in military units. At the least party-political training in the forces is likely to be downgraded, undercutting the MPA and its chief, General Lizichev.

Finally, disillusion has gripped even senior officers as perestroika falters economically and threatens to fragment the USSR into national groups. The majority also fear over-hasty decisions spurred on by the climate of military cuts, are defensive over reformist ideas issuing form military ranks and bitterly resent the role of civilian critics. Yet growing cynicism among higher military circles has not spilled over into open disloyalty to the political authorities.

Roy Allison

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CONSTITUTION

LAW GOVERNED STATE

Changes afoot

THE process of the creation of a law governed state is the success story of the five years of President Mikhail Gorbachev. Not just successful: breathtakingly successful, on a scale and with a speed which no one could have imagined at the beginning of his tenure of office.

The period has seen the ending of a totalitarian state and the emergence of a chaotic period in which at every level debate and struggle focus on the way in which the Soviet peoples are to be ruled. This has been violent and will be again. It could not be otherwise given the violence of the creation and consolidation of the state. But now, even the violence is usually significant of some kind of liberation, at least of expression, not that of a hopeless throw against gathering tyranny.

That, for all its brilliance, the process may yet fail is a measure of the depth of the task which the reformist leadership took on, and the size of the contradictions which they summoned up by unleashing it in the first place.

However, if reform succeeds – by which can only be meant, that it continues to stagger through crises while still proceeding in the direction of a liberalised polity and economy – it will be largely because a state of law is painfully being built.

The Gorbachev period so far has seen many of the right things destroyed, and more of the right things created. In the first category, Mr Gorbachev has wittingly or unwittingly destroyed belief in the following:

- the unity of the Soviet Union;
- the command system of production and supply;
- the leading role of the party, and with it the supreme theoretical role of Marxism Leninism and the politicisation of everyday life.

There are signs that these new practices are becoming entrenched which bode well for a state of law. For out of the ferment in the republics is growing a care for democratic and constitutional forms, both within the areas for which they seek autonomy and independence, and to govern the relationship between them and the centre.

The elected Congress of People's Deputies and a reshaped Supreme Soviet convened for the first time 10 months ago, yet it is now part of political life and contains a plurality of opinions which are begining to form into proto-parties. Moreover, it has confirmed – and rejected – ministers, passed laws introducing a presumption of innocence clause in the law and scrapped the notorious catch-all charge of "slandering the Soviet system".

It has refused to ban strikes, to levy penal taxation on co-operatives, to raise tax on beer and cigarettes and it has granted economic autonomy to the Baltic republics.

Its deputies – most authoritatively, the late Dr Andrei Sakharov – have argued publicly and vehemently with Mr Gorbachev and other high state and Party officials. And it has all been on television.

Its very success has directly affected the position of the Communist Party. Its operation has shown that the Party's "leading role" and monopoly of power was both absurd and was being challenged with impunity throughout the country.

There is now a public opinion. It is febrile, intense and inexperienced and it has clearly signalled its dislike of the Party's monopoly

Thus the decision by the Central Committee plenum early last month to scrap Article Six of the constitution guaranteeing the leading role of the party (or, significantly, requesting the Supreme Soviet to so amend the constitution) was the recognition of an already established fact. The Party *was* no longer leading: the monopoly *was* broken.

However, official confirmation of this has put a fillip behind efforts to create a constitution, efforts towards which have been in a curious suspension over the past two years, with "conservative" and "radical" drafts circulating, but no decisions being taken.

Mr William Smirnov, director of the department for political studies at the Institute of State and Law, says: "Since the plenum, discussions are becoming more urgent. The prevailing mood among legal circles is that it should be a really legal constitution – not one which mentions the kind of society and state we will have; to make it an expression of the law, not one which lays down the values of socialism and communism."

What Mr Smirnov proposes is a logical next step to the loss of political monopoly. That is, a constitutional settlement which guarantees civil rights and describes electoral and judicial mechanisms, but is not prescriptive as to political outcomes – a complete departure for a state in which socialism is the presumed input to and outcome of all state acts.

In that sense, the removal of Article Six of the constitution is only a first step. The deconstruction of an ideological constitution must proceed from the bottom up, engaging even with the very name of the state itself.

The current session of the Supreme Soviet and of the Congress will be critical in this instance. It must consider five draft laws on the relationship between the republics and the centre, and between republic and republic; it must finally get to a draft law on the press; it must decide on a framework for new parties; and it must conclude whether or not it wishes to legalise private property. At some point, too, it must intervene to sort out the confusion over the reform of the legal system itself.

The momentum of constitutional change it has already initiated has been great. But still, as Mr Vitaly Tretyakov, deputy editor of Moscow News, points out: "We can still revert to the days of stagnation if one man – Mr Gorbachev – is removed."

This overstates the case: it points up, however, how much is owed to reformist personalities, how slender still is the legal basis for enshrining the changes made.

There is, finally, the matter of the creation of a public opinion and a civil society which are the ultimate guarantees of any constitutional and democratic state. For if the people do not insist on democracy and the rule of law, leaders unused to either will be unlikely to provide it.

There *is* now a public opinion. It is febrile, intense and inexperienced and appears to be against co-operatives (and is certainly against price rises); but it has also clearly signalled its dislike of the Party's monopoly and its desire for a constitutional state in which not just the party, but the police, KGB, judiciary, enterprises and unions were subordinate to the law and able to operate independently of political and state pressures.

The larger question is how far this public opinion can be expressed at the federal level. In the end, that will determine the entire process. It will not mean an end to law governing, but it will mean an end to the state as presently constituted.

John Lloyd

PRESS

An age of enquiry

MR IVAN Laptev, editor of Izvestia, is perhaps a better model of the senior Soviet newspaperman in the age of Gorbachev than his higher profile colleagues, such as Mr Vitaly Korotich of Ogonek or Mr Yegor Yakovlev of Moscow News.

He has been a considerable reformist, pushing the government paper into campaigning and enquiring journalism, encouraging a talented team of columnists like Mr Alexander Bovin and Mr Melor Sterua. At every step of the way, though, he has worried – "Was I going too far ahead of my readers?"

An example. Three years ago, he wanted to campaign against the practice of erecting busts of those who had been twice awarded "Heroes of Socialist Labour." He had an article written "but I was afraid to use it, because the leadership were all for the custom and so were many workers. Now, it is widely discussed and it seems everybody is against it."

He sees two main phases in the liberalisation of the press. First, the extraordinary Central Committee plenum of April 1985, a month after President Mikhail Gorbachev came to power, at which "the new programme of perestroika gave us hope".

The second moment was the publication, in the spring of 1988, of the "Nina Andreeva letter" – a letter from a Stalinist teacher, published in Sovetskaya Rossiya newspaper, violently critical of liberalisation and seen at the time as the herald of a new reaction.

Pravda lamely reasserted the leadership line some two weeks later. Mr Laptev and his colleagues were shaken, "but we talked together and decided to continue our line as long as we could".

But he is *for* perestroika: and that means he is for Mr Gorbachev, in a way no western newspaper editor could afford to be for a prime minister or political leader. When, last autumn, Mr Gorbachev called in the newspaper editors and harangued them for irresponsibility, Mr Laptev thought about it, reviewed his material "and realised Gorbachev was right. So I told my colleagues that we must work more carefully."

It was at that same meeting that Mr Vladislav Starkov, editor of Argumenti i Fakti, a hugely popular weekly, was reported to be under threat of the sack. "Mr Gorbachev didn't actually sack him. He said: 'If I was in your place I would resign.' But he hasn't resigned, he carries on," said Mr Laptev.

Mr Albert Vlasov, chairman of Novosti, the press agency, is dismissive of allegations of control from above.

"We're an independent agency, we publish our own points of view." That is increasingly true; and it is increasingly the case that these views clash, though how deep is the debate is another matter.

Mr Vlasov has seen a 30 per cent turnover in his staff in the past 18 months, as the old guard who are unable to accustom themselves to the changes leave, and new ones are recruited.

There are other inhibitions than the purely political. Mr Korotich at Ogonek, nothing of his vigour seemingly yet impaired, says he cannot get the paper he needs, cannot get the printing capacity he needs ("I have to print a weekly two weeks ahead of publication!") and cannot pay the staff what they deserve.

"Our circulation has gone up from 260,000 in 1986 to 4.6m now. Pravda's circulation has halved. And still they pay Pravda journalists three times our rates." The censor, he says, is still about – though he causes less trouble.

He, too, thinks that the press remains protected – while Mr Gorbachev remains in charge.

"After that meeting with Mr Gorbachev last year nothing happened. He showed the conservatives that he could shout at us and that was all. Perhaps it is a sign that democracy has arrived: the leader makes a fuss and nothing happens.

"We are not untouchable. Mr Gorbachev is not untouchable. But we exist in the struggle now. I feel hated, but I also feel supported. The battle will be open."

Still, most journalists feel too dependent on the figure of Mr Gorbachev for comfort. Says Mr Vitaly Tretyakov, deputy editor of Moscow News: "With Mr Gorbachev gone, the whole thing could collapse. It still all comes down to him."

Journalists want something in writing, and they will probably get it in this session of the Supreme Soviet.

The Draft Law on the Press has been kicked about for at least two years, first under the conservative tutelage of Mr Victor Afanasev, the former editor of Pravda, and now under the more reformist oversight of Mr Georgi Shakhnazarov, a former researcher at the Institute of State and Law and now an aide to Mr Gorbachev, as well as chairman of the standing committee on the law on the press.

He believes the law should be ready to be tabled and passed this session. He is certain it is liberal, and will bear comparison with any in the world.

Only two things trouble him – "and they are matters of controversy everywhere". First, should an individual, as against a group or enterprise or party, be allowed to start a paper.

"If we allow individuals to start them, we risk such massive powers as (William Randolph) Hearst had and (Rupert) Murdoch now has. To us they are symbols of men who command too much political influence. The international democratic movement as a whole has not found a solution to this problem. The second issue is who controls? The publisher or the journalists?

"We believe the publisher should not have the right to censor an article – he must be given rights of influence, otherwise why bother to publish at all? He should have rights, and the editor and the journalists should also have rights, in balance. Certainly, the journalist has the right to refuse to write something against his conscience."

One consequence of the Press law might be a certain falling off of the presently very great availability of "unofficial" papers – printed by groups, proto-parties, ecological clubs and individuals with something to say all over the country.

Mr Shakhnazarov reckons there to be 2,000 of them. The new law will force them to declare their editor's name, where their financial support comes from and what their editorial line is. Some may find this requirement too restrictive, and drop out.

The relative freedom of the press has been the more remarkable since it is wholly a Party or state-owned press. The new law should permit private, or at least co-operative, ownership.

But any guarantee for its independence depends on the creation of democratic and market institutions.

John Lloyd

Writing on the wall: A Leningrad reader catching up with the news. The relative freedom of the press has been the more remarkable since it is wholly a Party or state-owned press

CONSTITUTIONAL REFORM

Foundation laid for new system

THE CENTRAL element of President Mikhail Gorbachev's "New Political Thinking" has been the creation of a rule-of-law state in the Soviet Union. Glasnost and perestroika are instruments to this end, but the real innovation in Mr Gorbachev's policy is that law – for the first time in Soviet history – is accepted as a universal human value and not merely a means to an end.

The full implications of this view for Marxist theory have yet to be explored, for classical Marxism always has emphasised that state and law are ultimately doomed to wither away, to disappear under communism.

Be that as it may, the foundation stones are being laid for its creation. Constitutional reform, Mr Gorbachev said, will be undertaken in stages. The first occurred in December 1988 when the USSR constitution was amended to create a new parliamentary body – the Congress of People's Deputies of the USSR – and to introduce experimentally an election system under which multiple candidacies would be allowed. Further, a Constitutional Supervision Committee was to be formed, and the role and prestige of the courts and the legal profession were to be enhanced.

There has since been institutional progress. The parliament was formed in June 1989 and, though cumbersome with 2,250 members, seems to be emerging as an independent force even though 89 per cent of the deputies are members of the Communist Party. Its televised proceedings captivate the nation.

The introduction of a Presidency into the USSR constitution, for which the Congress of People's Deputies has been convened in extraordinary session, is attributed to this need for expeditious resolute action.

The December 1988 constitutional amendments called for adoption of legislation protecting the independence of the judiciary. In August 1989 a law on the subject was enacted, followed in November by three further enactments on the recall and disciplining of errant judges. Republics have been given the right to introduce the jury system in selected criminal cases.

"Telephone law" has received a lot of attention in the Soviet press, such that when candidates were put forward for election to the USSR Supreme Court, the deputies asked each whether he or she had ever been the recipient of telephone calls attempting to influence their decision in a case. All denied any such occasion, but the issue remains in the public mind and has become punishable in the new legislation.

The real innovation in Mr Gorbachev's policy is that law – for the first time in Soviet history – is accepted as a universal human value and not merely a means to an end

The experiment in spring 1989 with multiple candidacies was considered to be successful and has been much expanded in the republican and local elections this spring.

In December 1989 the USSR constitution was again amended in regard to elections, this time to eliminate the automatic one-third of deputies in the Congress of People's Deputies who are indirectly elected by social organisations (the Communist Party, unions, unions of writers, composers, artists, etc). In the next round, no Party will be automatically assured of representation.

Lawyers are taking their own measures to enhance the profession. Fees have increased slightly, but more importantly ceilings on earnings have been lifted and lawyers are at liberty to negotiate individual fees with foreigners.

Two professional societies have been created. The Union of Jurists embraces lawyers of whatever kind (practitioners *jurisconsults, advocates, judges, arbitrators, academics,* procurators, investigators, etc) and has a potential membership of more 30,000. The second, the Union of Advocates, accepts only advocates as members.

Judicial review of the constitutionality of legislation, so hallowed in the US, was mooted when the USSR constitution was changed to allow the appointment of the Constitutional Supervision Committee. Several times in 1988-89 union republic laws have been declared unconstitutional by the Presidium of the USSR Supreme Soviet, which presently has jurisdiction over such matters. But when in June 1989 the government proposed candidates for the Committee, the Congress of People's Deputies refused to approve them pending the adoption of a law on the Committee which would define its powers and functions.

The republics were fearful that the Committee would become a powerful arm of central government. In the end, the constitution was again amended in December 1989 to increase the Committee membership so that every republic would be represented. And instead of a body modelled on the US Supreme Court, there emerged a pallid supervisory body with what, on paper, are rather limited powers to draw the attention of other agencies to unconstitutional enactments.

However, in Professor S.S. Alekseev, *the chairman of the new Committee, the country has an imaginative jurist capable of developing the Committee's powers to the full extent permitted by the law.*

The staged approach to constitutional reform may be short-lived. In November 1989 the Supreme Soviet quietly appointed a commission to draft a new constitution. If a draft is produced (Khrushchev appointed such a commission in 1962; it reported in 1977), it would represent the fifth generation of Soviet constitutions since the revolution (1918, 1924, 1936, and 1977).

Here, however, the likelihood is stronger that the Congress of People's Deputies may abandon staged reform for a full scale replacement of the present constitution.

Quite apart from the new presidency, the reforms in land legislation and the law of ownership also require constitutional alterations. The issue is not public versus private ownership, but how a reforming system develops responsive concepts of property which enable it to be deployed most effectively in the interests of the individual and society alike.

William Butler

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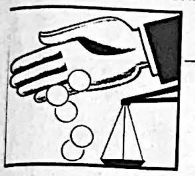


Martin Wolf examines the fundamental problems of an economy which produces satellites but not enough soap

Death rattle of the Stalinist war economy

ECONOMIC reform in the Soviet Union faces three obstacles: the legacy of the past; the chaos of the present and the conflict over the future. Five years of experience with perestroika have made the obstacles look more formidable. It has always seemed unlikely that changes which challenge two generations of history will be brought about peacefully. They now look far more difficult than five years ago.

Economic reformers talk of the need to create "a normal economy". They mean by this a market economy, even if it is often qualified by the word "socialist". "There is no worthy alternative to the market as the method of co-ordinating the activities and interests of economic agents," states the document put forward, with President Mikhail Gorbachev's backing, by Deputy Prime Minister, Mr Leonid Abalkin, to an "All-Union Conference and Workshop on Problems of Radical Economic Reform" last November.

One way of thinking about the abnormality of the Soviet economy is that it is an extreme type of a war economy. More is involved here than the burden of expenditures on defence. Also significant is the focus on heavy industry and indifference to consumption; the economy's isolation and extreme centralisation; the repressed inflation; the appeals to collective sacrifice; and the paranoia. The war economy has satellites, but insufficient soap, missiles, and very little meat.

The scale of the upheaval entailed by economic reform was not understood five years ago. Academician Mr Abel Aganbegyan, for example, expected that, as a result of perestroika, "the Soviet national income by 2000 would closely approach that of the US".* But the real challenge is to avoid falling still further behind. Now, after almost five years of failure, this is at last recognised.

Dr Aganbegyan's analysis does at least explain why percipient economists had concluded that radical change was essential. Economic growth was declining, quinquennium by quinquennium, even on the official statistics, but Dr Aganbegyan agrees with western critics that these statistics were lies. In his view the economy had become stagnant by the early 1980s. The Stalinist approach of throwing in ever more resources had reached its limits.

As Soviet growth has slowed, so has the rate of growth of the capital stock. The rate of growth of the labour force declined sharply as well, along with that of the availability of natural resources. Meanwhile, economic efficiency (total factor productivity in western parlance) rose by little more than 1¼ per cent a year after 1970, even on the official figures. If Dr Aganbegyan is right in his view of Soviet growth, there must have been no productivity growth in the 1970s and a decline of about 8 per cent during the first half of the 1980s.

This desperately poor productivity performance was no accident. A huge proportion of Soviet resources are wasted on tanks and rockets. Investment is grossly inefficient (one study showing an average construction period on 800 large machine-building projects of 13 years). There is little incentive to increase efficiency, especially when so many enterprises are giant monopolies. Last but not least, while the advanced industrial countries were in the throes of the information revolution, the Soviet Union was years behind in the basic technologies and regarded information itself as a contagious disease.

Diagnosis was one thing; finding a cure another. The CIA estimates that, after a short-lived surge in 1986, gross national product rose by a total of 1¼ per cent over the ensuing three years, while GNP per head fell by more than one per cent. Moreover, this is the good news. The bad news is that the economy is threatened by inflation of Polish proportions.

Even the official statisticians suggest that inflation was 2¼ per cent in 1989, but then add another 5 percentage points for the non-availability of goods. The procedure is peculiar (since the non-availability of goods should appear in the figures for output, not prices) but the point is sound. For citizens and visitors, the non-availability of almost any good one cares to name, except the rouble, has become the economy's salient characteristic.

How have five years of perestroika managed to turn the chronic ailments of the Soviet economy into a critical disease? The answer is that a deeply divided and weakening central government has pursued policies that were internally contradictory and too often ill-considered. Perhaps the most fundamental, and most frequently recurring, conflict is between disciplinary campaigns, on the one hand, and a shift to market mechanisms, on the other.

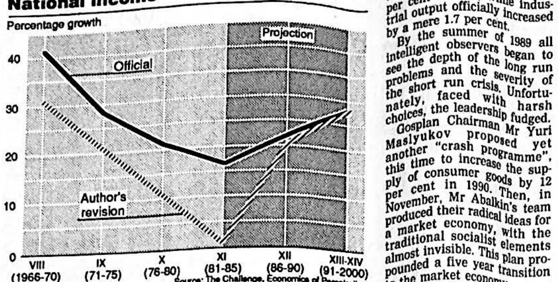
In the spring of 1985, acceleration of the country's social and economic development was Mr Gorbachev's main demand. This acceleration programme was a disaster, exacerbating bottlenecks in the economy and providing a boost to largely unproductive investments.

Equally disastrous was the anti-alcohol programme, described by Anders Aslund** as "a full-fledged disciplinary campaign of the old style". The short term effects were impressive, the longer term ones catastrophic, including a huge increase in illegal distilling (with no fewer than 900,000 stills confiscated within a year and a half) and an important loss in government revenue.

The failure of crash programmes of the traditional kind seems to have gone some way towards persuading Mr Gorbachev that something different and more radical was required. The watershed was the plenary meeting of the Party's Central Committee in June 1987. This was followed, shortly afterwards, by the Law on State Enterprises and, almost a year later, by the Law on Co-operatives.

Unfortunately, both these market-oriented reforms were hamstrung from the start. The Law on State Enterprises endorsed a mutually incompatible combination of enterprise independence with centralised management (enforced through discretionary taxation and state orders, which still cover more than 80 per cent of the total output of state enterprises). Equally half-baked was the introduction of co-operatives, which remain outside the system of state supply and attract the resentment attendant upon their inevitable links with grey and black markets.

National income



Source: The Challenge, Economics of Perestroika by Abel Aganbegyan

Some people believe that it would be easier for the Soviet Union to achieve communism than return to capitalism

At least these efforts have been educational. They demonstrate that one cannot have just a bit of a market. But they also show that the crumbling political system can disorganise the existing system far more easily than reform it.

Of nothing is this more true than of money. At the heart of the current problem is the deficit in the state budget (on which information was at last provided in 1989). As a consequence of the investment expansion, the anti-alcohol campaign, increased social expenditures and the fall in the world price of oil in 1986, the deficit increased from Rbs18bn (2.7 per cent of GDP) in 1985 to Rbs90bn in 1988 and Rbs92bn in 1989 (around 11 per cent of GDP in both cases). After strenuous efforts, the deficit is expected to fall to 6 per cent of GDP in 1990.

Since 1984 the ratio of liquid savings deposits to retail sales has risen from 64 per cent to 86 per cent, while government debt has risen from 16 per cent to around 45 per cent of GDP. Goskomstat, the official body responsible for statistics now estimates the monetary "overhang" at Rbs165bn, which is close to 40 per cent of the liquid assets (in cash and savings accounts) of the population. The State Bank may argue that the overhang is "only" Rbs130bn, but does not doubt that it is huge.

The worthlessness of the currency also undermines economic decentralisation. Who would work harder to earn useless pieces of paper? At the same time, enterprises make things worse, by engineering concealed inflation through changes in their product mix and then paying higher wages (a process condemned as "group egoism"). The breakdown in central control over the wage funds of enterprises allowed wages to rise by 10.9 per cent in 1989, while industrial output officially increased by a mere 1.7 per cent.

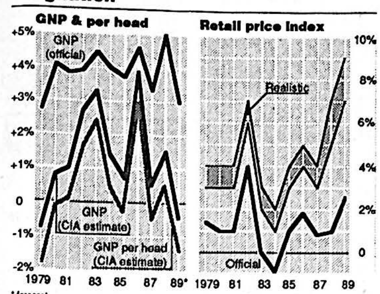
By the summer of 1989 all intelligent observers began to see the depth of the long run problems and the severity of the short run crisis. Unfortunately, faced with harsh choices, the leadership fudged.

Gosplan Chairman Mr Yuri Maslyukov proposed yet another "crash programme", this time to increase the supply of consumer goods by 12 per cent in 1990. Then, in November, Mr Abalkin's team produced their radical ideas for a market economy, with the traditional socialist elements almost invisible. This plan propounded a five year transition to the market economy.

Alongside Gosplan's proposed emergency measures, 1990 was to see the working out of "reforms of price formation, labour remuneration and social security" and the closure or transformation into "leasehold, co-operative and joint-stock entities" of "all unprofitable industrial enterprises"; then, in 1991-92 the new economic mechanism would be launched, with closure or transformation of all "unprofitable state and collective farms"; finally, in 1993-5, the market mechanism would take centre stage, with completion of financial recovery and an anti-monopoly programme.

In spite of Mr Gorbachev's support the Abalkin programme ran into fierce hostility. In any case, the subsequent proposals of Mr Nikolai Ryzhkov, the Prime Minister, in early December appeared both to question the goal of the reform and change the time-table. The solution to the immediate crisis lay in a switch from heavy industry to consumer goods, rather than too fast a switch to a market economy. Plans to reform farm gate prices for foodstuffs were postponed to 1991. Retail prices would not be changed before 1992, and then only after a "nationwide debate".

Stagflation



Source: PlanEcon & official figures

One way of thinking about the abnormality of the Soviet economy is that it is an extreme type of a war economy

Mr Ryzhkov's intervention leaves the Abalkin programme as the blueprint for the re-orientation of the economy. Its significance is moot, however, since it seems inconceivable that the Soviet economy will be stabilised in 1990. If so, neither price reform nor a move to the market is likely.

The expected boost in the output of consumer goods in 1990 (now Rbs60bn or 15 per cent) looks like just another over-optimistic crash programme. The budget deficit may be reduced as planned, but it would still be 6 per cent of GDP. The envisaged sale of various bonds will at best neutralise the monetary effects of this year's budget deficit, but will do nothing about the monetary overhang. The plans for penal taxation of high wage increases contain too many exceptions.

More radical programmes can be envisaged. These would include elimination of the budget deficit, monetary reform and acceptance of a degree of inflation (along with measures to protect vulnerable groups). Such an emergency programme could be followed by a radical price reform, which would, in turn, set the basis for market formation of prices, greater decentralisation of enterprise, a vigorous anti-monopoly policy and partial convertibility of the rouble.

Yet the Government shows no stomach for the radicalism that has any chance of working. There are several reasons for this reluctance: the scale of the upheaval that would unquestionably follow; ideological blinkers; the opposition of an apparatus that contains some 18 million members, all of whom actually or potentially benefit from the power and perquisites given them by the shortage economy; and, perhaps most important of all, the antipathy of a population taught for 70 years to despise everything – success and failure, unemployment and inequality, profits and property – that makes an market economy work.

The market cannot just be a pretend, "socialist" one. It must be a real one, with real consequences and real casualties. But such reforms would not only defraud the people of what they thought were their earnings, but of almost all they have been taught and were told they had achieved over three generations. No wonder some say that it would be easier for the Soviet Union to achieve communism than return to capitalism. Unfortunately, a smooth transition to a "planned market economy" looks more unlikely than either. The war economy is dying, but there is as yet no successor, except chaos.

* *Abel Aganbegyan, The Challenge: Economics of Perestroika (London: Hutchinson, 1988)*

***Anders Aslund, Gorbachev's Struggle for Economic Reform: the Soviet Reform Process 1985-88 (Ithaca, New York: Cornell University Press, 1989)*

ECONOMY

A GLOBAL COMPARISON

Measures of the task ahead

HOW LARGE is the Soviet Economy? How does its structure differ from that of the leading industrial countries?

Now that gross national product is estimated by the Soviet statistical authorities, these questions might sound quite simple to answer, but they are not. This is not only because Soviet statistics are particularly unreliable, but also because the official exchange rate for the rouble is arbitrarily determined and the structure of prices in the Soviet Union is also very different from that in the West.

At the average official exchange rate of $1.59 to the rouble, the Soviet Union's gross domestic product in 1987 would have been only $1.3 trillion (million million). In that year the GNP of the US was $4.5 trillion, Japan $2.4 trillion and West Germany $1.1 trillion. On this basis, therefore, the economy of the Soviet Union was considerably smaller than that of Japan and little larger than that of West Germany.

But the Soviet Union is more economically powerful than that. The size of its economy must be recalculated, using not the official exchange rate, but a common set of international prices.

For the western economies such purchasing power estimates of GNP are computed by the European Community and the OECD; for the Soviet Union comparable estimates have been prepared by Mr Boris Bolotin, a researcher at the Institute of World Economy and International Relations.

Such estimates are unavoidably rough and ready, particularly when the quality of Soviet goods is so much worse than of those of the West. But Mr Bolotin's estimates of the overall size of the Soviet economy are at least close to those of analysts in the CIA. (But note the uncertainty. PlanEcon – a well-informed, Washington-based organisation – suggests that the Soviet economy may be 40 per cent smaller than the CIA estimates.)

According to Mr Bolotin's estimates, revalued at "international" prices (an average of prices in the Soviet Union and in the countries of the OECD, weighted by their GNP) the GDP of the Soviet Union would have been $2.2 trillion in 1987, about half that of the US, but bigger than that of Japan, which shrinks to $1.8 trillion (because of the exceptionally high price of services in domestic prices).

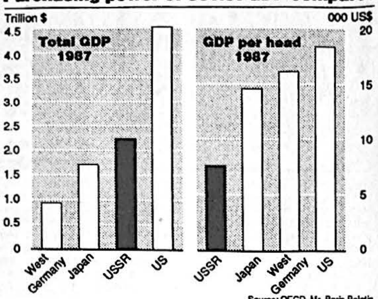
The Soviet economy also turns out to be more than twice as large as that of West Germany. (On PlanEcon figures, however, the purchasing power of Soviet GDP would have been only $1.5 trillion, less than that of Japan.)

The Soviet Union is unquestionably a poor country, its overall economic size being explained by its large population. GDP per head on a purchasing power basis – estimated by Mr Bolotin at $7,900 in 1987 – was 42 per cent of that of the US and about half those of West Germany, Japan, France, the UK and Italy (all of which are fairly close together). Real GDP per head in the Soviet Union would then be close to that of Greece. (On the PlanEcon estimate, Soviet GDP per head would be closer to that of Turkey.)

What is more, the improvement in the Soviet Union's relative position since 1913 appears to have been modest. According to Mr Paul Bairoch*, Russia's GNP per head in 1913 (in 1960 dollars and prices) was a third of that of the UK, 43 per cent of the German level, 47 per cent of the French and 74 per cent of the Italian. While the improvement relative to the UK appears to have been substantial since the Revolution, that against Germany and France has been small, while Italy has moved further ahead.

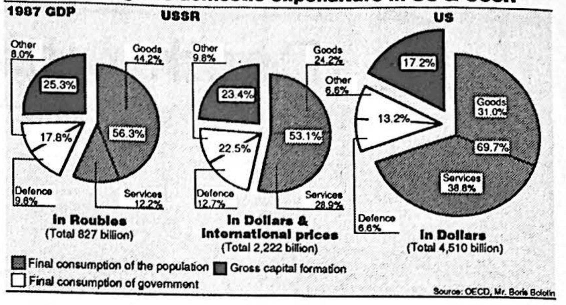
Soviet personal consumption is limited not only by the low average income per head, but also by its low share in Soviet GDP. In 1987 the share of Soviet GDP devoted to the consumption of the population (in domestic prices) was a mere 56 per cent, against 70 per cent in the US and 60 per cent even in Japan.

Purchasing power of Soviet GDP compared



Source: OECD, Mr. Boris Bolotin

Structure of gross domestic expenditure in US & USSR



Source: OECD, Mr. Boris Bolotin

In domestic prices almost two thirds of Soviet final consumption (which includes government-provided personal consumption) goes on food and clothing, a much higher proportion than in the leading industrial countries.

A far smaller proportion of such consumption goes for personal transportation (cars), housing, education and medical care. In "international" prices, expenditures on personal transportation shrink to almost nothing, while those on health remain remarkably low, at only 4½ per cent of GDP (as against 11½ per cent in the US).

The low share of Soviet personal consumption in total expenditures partly reflects the high share of government consumption. Defence spending was particularly onerous, at 9.8 per cent of GDP in domestic prices (on the official figures) and 12.7 per cent of GDP in "international" prices.

Western analysts argue that defence spending is, in fact, substantially higher than officially indicated, perhaps as much as 13 per cent of GDP in domestic prices and 17 per cent in US prices.

The investment effort is almost equally impressive. Of the leading industrial countries only Japan invests a larger share of GDP than the Soviet Union.

Yet, correctly measured, Soviet income per head seems to have stagnated for over a decade. No more powerful indication could be given of the extent of the inefficiency that President Mikhail Gorbachev's economic reforms are intended to remedy.

Martin Wolf

* *Paul Bairoch, Europe's Gross National Product 1800-1975, Journal of Economic History, 1976, p. 297*

INTERNATIONAL TRADE

An outsider knocking on the West's door

"THE WORLD economy is becoming a single organism, and no state, whatever its social system or economic status, can normally develop outside it." So said President Mikhail Gorbachev in a speech to the UN General Assembly in December 1988. In a subsequent speech in London in April 1989, he asserted, quite bluntly, that "our economic reform presupposes the Soviet Union's closer integration into the world economy."

No country has tried harder to develop outside the world economy. The Soviet Union is, as a result, a peripheral player in both world trade and investment, which are, in turn, marginal in the economy of the Soviet Union. The lengths to *which it has gone are a measure of the changes that will be* required if it is to integrate within "the single organism" of the world economy.

For example, the rouble remains almost entirely unconvertible into foreign exchange (or, indeed, anything else). Moreover, a combination of foreign exchange retention quotas and 3,000 product-specific coefficients for conversion of foreign currency into roubles has created one of the world's most elaborate multiple exchange rate systems.

While designed to encourage processing of raw materials, the number of foreign exchange coefficients also reflects the isolation of domestic from world prices. According to calculations done at the State Bank, the purchasing power exchange rate for the rouble varies between 30 kopeks to the dollar for food (at official prices), to between Rbs3 and Rbs5 to the dollar for many consumer goods, to Rbs30 to the dollar for more sophisticated consumer goods, like video-cassette recorders.

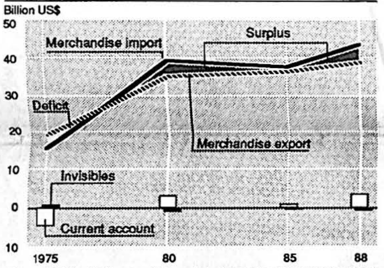
An inevitable consequence of the isolation of the domestic from the global economy is that the Soviet Union exports rather little, while its pattern of exports is that of a third world country. Thus, in 1988 about 36 per cent of Soviet exports to the non-socialist world consisted of fuel and 43 per cent of its total exports were of petroleum and gas.

In 1988 total Soviet exports were $111bn, of which only $43bn were for convertible currency, while Soviet imports in that year were $107bn, with $39bn in convertible currency, leaving the country with a modest current account surplus (in convertible currencies) of $3.8bn (after allowing for invisibles).

According to the Gatt, this overall performance made the Soviet Union the world's eighth largest exporter, coming just after Canada and accounting for 3.9 per cent of world exports (which can be contrasted with the West German share of 11.2 per cent and the US share of 11.1 per cent.) On this basis, the Soviet presence in world trade is not insignificant. But that conclusion is misleading in two respects.

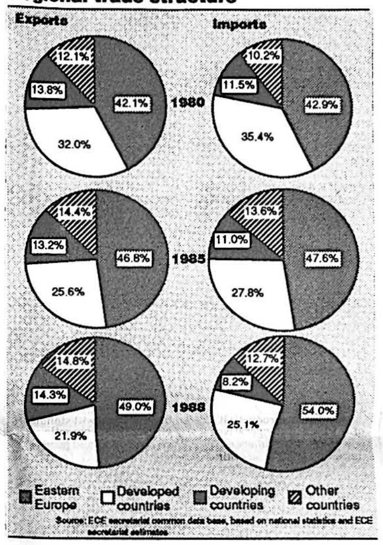
First, if one looks at exports for convertible currency (and so subject to free international competition), the Soviet share of world exports is well below those of small economies such as Taiwan, Hong Kong, South Korea, Switzerland or Sweden. Second, only 47 per cent of Soviet exports to non-socialist countries were manufactures. At around $20bn, these exports were less than half those of Hong Kong or South Korea and were dwarfed by those of the leading western economies.

Balance of payments in convertible currencies



Source: ECE Secretariat common data base, derived from national & international statistics & ECE secretariat estimates.

Regional trade structure



Source: ECE secretariat common data base, based on national statistics and ECE secretariat estimates.

This feeble export performance must be transformed if an increasing proportion of Soviet output is to be made subject to international competition (whether at home or abroad). Without expanded exports of manufactures for hard currency, imports will remain constrained by the limited Soviet capacity to increase its external borrowing (a concern to the Soviet authorities already) and by its still more limited capacity to expand exports of petroleum.

It is true that new arrangements within Comecon will, in time, increase Soviet hard currency revenue from energy exports. Yet even that silver lining has a cloud, since Soviet enterprises will lose a protected export market.

Radical change may be needed, but – as in other areas of Soviet economic life – reform has been half-hearted so far. Domestic prices remain as divorced from those in the world market today as five years ago and the rouble is, if anything, still further from convertibility. Unsurprisingly, trade performance has failed to pick up.

The most interesting changes have been the somewhat restricted permission to enterprises to make their own trading arrangements and the encouragement of joint ventures. The former demanded a vigorous assault on the previously all powerful Ministry of Foreign Trade.

At the strategic level the State Foreign Economic Commission was established as a "super ministry" in charge of policy-formation in external economic relations. Meanwhile, 12,680 organisations (more than a quarter of the larger enterprises) have registered their intention to conduct external trade on their own behalf.

One problem created by the freedom granted to enterprise is that, in their desperation for hard currency, they are prepared to sell almost anything they can get their hands on. Several scandals have been the inevitable consequence of granting such freedoms in the context of the hugely distorted Soviet economy. As with the co-operatives, these scandals tend to discredit the whole idea of decentralisation in trade.

Some 1,264 joint ventures from 60 countries have now been registered, but only 200 are operating, mostly on quite a small scale, the average capital employed in the more recent joint ventures being a mere Rbs3.3m (£3.3m, at the official exchange rate).

As Mr Ivan Ivanov, deputy chairman of the State Committee on Foreign Economic Relations remarks: "Joint ventures are just one channel" for opening the Soviet economy. He also describes them as a "model of the the post-reform Soviet economy". In the pre-reform economy, however, they are of marginal importance, partly because of the obstacles they face, the greatest being obtaining supplies in a Soviet economy which still works on administrative lines.

'Our economic reform presupposes the Soviet Union's closer integration into the world economy'

Meanwhile, the Soviet Union is flirting with the idea of membership of the Gatt and the International Monetary Fund. But, however symbolic this would be, membership of these institutions is a side show. Mr Gorbachev's desire for integration of the Soviet into the global economy is waiting for Godot: meaningful economic reform at home.

Martin Wolf

Interview: Gavril Popov

The party as villain

MR GAVRIL Popov – member of the USSR Academy of Sciences, editor of Problems of Economics and leading member of the co-ordinating committee of Democratic Platform, the radical faction in the Congress of People's Deputies – is a 'left winger' in Soviet parlance. In the West he would be seen as a blend of an egalitarian and a classical liberal.

Professor Popov argues that "economic reform has come to a point where it directly touches upon the privileges of the communist apparatus and even threatens its very existence.

"This is why external pressure must be imposed either by the Supreme Soviet or by the Party Congress." These bodies will push only if pushed, in turn, by the people. "Neither Gorbachev nor Ryzhkov is able to introduce these changes on their own initiative," he asserts.

The public is against price reform, he admits, but he ascribes this reluctance to the fear of being deceived once again by the government. "If other people come to power, whom the people trust, they will agree to the reform."

To alleviate popular resistance, Professor Popov argues for combining price reform with rationing of basic foodstuffs for the benefit of vulnerable groups, like pensioners.

A sharp decline in investment and defence spending "will release vast resources to the consumer sector, whereupon market prices will go down, though they will be higher than they are now.

"In any case, the government will end up with a system of rationing, but not until it has first ruined the country. Only members of the apparatus are against rationing, because they can now obtain supplies at the low official prices."

In addition, "a monetary reform must be introduced immediately." According to Professor Popov's proposal, people would have to justify the money in their accounts. If unable to do this, they would have the money confiscated or, more likely, would leave it unclaimed.

His proposal differs from that of the United Workers Front, a "conservative" populist movement, which favours confiscation of all sums over a certain amount – perhaps Rbs15,000 (£15,000 at the official exchange rate).

Professor Popov's intention, in contrast, "is to show as much consideration for the people as possible. This is why only 40 per cent of the surplus money would disappear as a result of the proposed reform."

The government may resist the idea, but "monetary reform is inevitable. The point is that 30-40 per cent of the population has no savings at all. They live on the verge of poverty. When real democracy appears in this country, deputies from poor regions will be under great pressure to carry out the reform and confiscate surplus money. So we have to be ahead of events.

"But once again we experience stubborn resistance on the part of the Party apparatus. The fact is that the money accumulated by members of the apparatus does not correspond to the low salaries they have had all these years. They have a lot of privileges which later turn into money savings."

The monopolisation of the economy is the most intractable long term problem, admits Professor Popov. None the less, he retains a radical vision of the future.

Ultimately, he hopes, 20 per cent of property will be in family hands, 30 per cent in the state sector and the rest in various collective forms, including share-holding and co-operatives.

Of the state sector only a third should remain in the hands of the central government, with the rest going to the republics.

Professor Popov regrets the failure of the newly-introduced draft law on property to include private property (other than family property).

Once more, he blames the Party, ascribing the failure to the attacks upon private property at the plenary meeting of the Communist Party's Central Committee in February.

Martin Wolf

Interview: Victor Geraschenko

Model central banker

Victor Geraschenko

"THE SOVIET people want a central bank that will sometimes say *nyet* to the Government." With these words Mr Victor Geraschenko, chairman of the State Bank of the Soviet Union since August last year, claims his independence. Equally bluntly, he asserts that "the decision to put the price reform under the table is unforgivable. We have lost two years. Economic reform will not work without price reform. The later price reform starts, the more time we will lose.

"The internal price system is such that we cannot work out a realistic rate of exchange for the rouble." Similarly, "our proposals for changes in interest rates cannot work without the price reform." Nowadays, he notes, enterprises only pay interest at around 2 per cent, "which is why enterprises have a huge stock of materials which they can use for barter purposes."

The State Bank proposes, instead, interest rates of 6 per cent on short term credit (of up to a year), rising to 9 per cent for credit of over three years. "Maybe we will introduce the reform in stages. But for industrial units we will be able to introduce the new interest rate structure in the second half of this year."

Even with price and interest rate reforms, "we will not be able to have an ideal banking system, in which the bank manager will be able to say 'no' to enterprises," he says. "The previous centralisation under the pretext of 'rational' development means that many enterprises are monopolies." Accordingly, "we will have administrative methods and bargaining between enterprises and the Government for a comparatively long period of time."

The current difficult economic situation Mr Geraschenko ascribes to "the changes introduced in 1987, under the belief that if enterprises were free to choose what to produce and how to satisfy market demand, everything would work perfectly." Control over wages was then lost.

"There has been a lot of discussion of the desirability of monetary reform. In my opinion monetary reform will not solve the problem." Mr Geraschenko notes that monetary reform must affect the bulk of ordinary savers. "Some people in trade unions say that a money reform would take money from the grey economy, but I do not think it would achieve this. The wealth of people engaged in the grey economy is in durable goods."

Not that Mr Geraschenko is any more enamoured of the Ministry of Finance's proposals for financing the fiscal deficit. The Ministry of Finance is planning to issue up to Rbs60bn (£60bn at the official exchange rate) in Treasury Obligations in 1990. The interest rate is to be 5 per cent and the plan is to start repayment in 1996. "Personally, I am not sure that this type of issue will work. I think the interest rate needs to be higher and the period shorter."

Mr Geraschenko's favoured method of soaking up excess liquidity – estimated by the State Bank at Rbs130bn, below the Rbs165bn estimate of the State Committee on Statistics – is the sale of the housing stock, not the sale of equity in enterprises (to which his objection is simply that there is not enough private liquid wealth).

Mr Geraschenko notes that "the exchange rate is unrealistic. Of course many people in the Soviet Union say we need to make the rouble convertible tomorrow, that this will solve all our problems. But I think this is ridiculous. Who will earn the dollars?" He also remarks that "we need to monitor the whole external situation. We need to be sure that we can repay."

Mr Geraschenko warns that the Soviet Union "is likely to go through a certain period of difficultly to control inflation." The question is whether the economic reform and the ambitious hopes for an independent central bank and financial system will survive the shock.

Martin Wolf

SOVIET FAR EAST

High hopes

THE Intourist Hotel in Khabarovsk, across the Amur River from the northern tip of Manchuria in the Soviet Far East, was in early February filled with a mixture of Japanese, Chinese, Americans, and Koreans, from both North and South.

This is to be expected, given the city's location. Yet it is none the less symbolic of what the Soviet government would like but has so far failed to achieve – broad integration of the Soviet Far East with the world's most dynamic economic region along the Pacific Rim.

In this sense, the Soviet Far East is a promise that has never been fulfilled. It is a vast area equal in size to Australia and accounting for 27 per cent of Soviet territory. Yet it is sparsely populated and rich in natural resources – timber, coal, oil and gas, and a host of minerals – that have never been fully developed.

Big infrastructural projects to develop coal and gas exports to Japan were seriously discussed more than 20 years ago, but these fell prey to the chilly relations between Moscow and Washington, when Japanese companies declined to move forward without US backing.

President Mikhail Gorbachev signalled a new thrust to develop the Far East in 1986, in his Vladivostock speech, where he called for closer ties with Asian nations. The speech was greeted with suspicion by the US and other nations of the Pacific, who feared expansion of Soviet naval and air power.

Although fear of Soviet power has receded, and the economic and trade climate has improved, hopes for rapid development of the Far East may still prove premature because of continued obstacles both domestically and with foreign partners.

A characteristically grand Rbs200bn investment programme by 2000 was fixed in 1986, following Mr Gorbachev's speech. Yet Mr Oleg Renzin, an economist at the Far Eastern Branch of the Institute of Economic Research in Khabarovsk, says the programme is already in deficit and the investment figures have been cut.

Even so, as Mr Renzin points out, this is not necessarily such a bad thing. As a less developed region, the Far East economy is less distorted by the Soviet central planners' obsession with producer goods. Mr Gorbachev's vision of Far East development emphasised raw materials and heavy industries, with provision of housing, food and consumer goods a mere afterthought. There is at least a possibility that Far Eastern development, integrated with regional economies, can be demand led and thus end up producing and trading for more useful goods.

The Far East is not a low-cost operating base. Severe Arctic weather conditions affect most of the area, and 80 per cent is in permafrost. This condition leads to water-logged surface condition in the summer months, because of poor drainage, and prevents normal building construction, which could melt subsurface ice and cause subsidence.

Labour recruitment and retention in the area has proved a persistent problem. Although wages are between 40-200 per cent higher than in central Russia, there is still little to be purchased. Housing is in short supply and cultural amenities are austere.

The Soviet Far East is a promise that has never been fulfilled

There are ambitious plans to expand electricity generating capacity in the region from current levels of 40GW to 110GW in the next 15 years. This would include a new nuclear plant, more large hydroelectric stations, a 100MW tidal power station, a vast increase in gas-fueled generators, as well as a 50 per cent increase in coal burning, even though coal's share of power generation is to drop from from 80 per cent to 50 per cent.

It remains to be seen whether these plans are financially or environmentally acceptable. Mr Anatoli Kolenchenko, chairman of the recently-formed Khabarovsk Territory Committee of Nature Protection, which must now sign off on all new industrial developments, calls the local environmental situation "alarming."

The Far East has large gas deposits in Yakutia and on Sakhalin Island. The Chinese have offered to build a pipeline from Yakutia into China at their own expense, which would allow production of more than 25bn cu m of gas a year. However, the project has stalled because of doubts over how the Chinese will pay for the gas.

Similarly, the Sakhalin project for gas export to Japan is stalled. Although the Soviets have been told the Japanese do not need the gas, the more likely reason is that Tokyo will frown on a project of this scope until resolution of its territorial dispute with Moscow. This, indeed, is inhibiting all Japanese companies, who have so far limited their involvement in the Far East to small-scale projects, such as fish or timber processing.

Hyundai has become the first South Korean company to open an office in Nakhodka, the seaport where a special economic zone is planned, and is expected to start exporting timber later this year. There is talk of a Khabarovsk Seoul air link. North Korea is setting up a joint venture to process ginseng, while China has a joint venture restaurant, the Harbin, in the city.

Two-way border trade with China in the Khabarovsk territory doubled last year to Rbs50m, although there are doubts about future growth after the licence requirements were imposed on local enterprises by the central government. Total foreign trade for the territory rose from Rbs300m to Rbs416m.

The US is also beginning to play a role. Flights to Anchorage are being planned. A small US joint venture is operating which provides services to visiting businessmen. Mr Renzin speaks optimistically about the future: "We have been accumulating and have such a large package of projects that this potential will inevitably come into being."

Yet what has happened so far is really small potatoes and it remains to be seen whether Moscow will set conditions to make large-scale foreign involvement of the sort envisioned attractive.

Steven Butler

CO-OPERATIVES

Right reform at wrong time

FOR President Mikhail Gorbachev and the radical *economic reformers*, co-operatives are a respectably Leninist route to a market economy.

The Law on Co-operatives adopted in May 1988 was correspondingly radical. As Mr Anders Aslund notes in his study of economic reform in the Soviet Union,* "the law illustrates how much easier it is for Soviet communists to accept the market than private ownership." Unfortunately, this turned out to be a case of the right reform at the wrong time.

At one level co-operatives have been a success. Mr Victor Georgiyevich Rudenko, president of the All-Russian Union of United Co-operatives and himself an active participant, cites some impressive statistics. In Leningrad, he says, there are now 7,000 co-operatives, employing 300,000. In the Russian Federal Republic as a whole co-operatives employ more than 1m, while their turnover has soared from about Rbs1bn (£1bn at the official exchange rate) in 1987 to Rbs30bn in 1989.

In essence, co-operatives are private businesses. A minimum of three founders is required, apart from the permission of the local authority, which must provide both registration and premises. Once established, the business can be resold; it is property.

Additional workers can join, either as partners or under a wage contract. People like Professor Alexei Sergeyev, an adviser to the conservative United Workers Front, complain about the lack of job security. But this is probably a small price to pay for the opportunity to earn a higher income.

"The labour productivity of workers in co-operatives was three, five and even 10 times higher than in ordinary production," reported Izvestia on February 27 1988. In addition, co-operatives have been able to provide services – in restaurants and medical services, for example – that are either far better than state provision or have no state equivalent at all.

Co-operatives stick out like a sore thumb. They were introduced into an economy (and society) that has no legitimate place for them

The high prices in co-operatives do not just affect foreigners. Ordinary Soviet citizens see both the high prices and, by their standards, huge incomes. State functionaries, in particular, feel the direct competition of co-operatives, complaining that "co-operatives will damage the state sector, because they will siphon off efficient and energetic co-operatives and good specialists and introduce mercenary motives into the moral atmosphere" (Izvestia, February 27 1988).

People moan about the new "millionaires". As supply conditions in state shops deteriorate – the inevitable consequence of the Government's inflationary policies and the collapse of wage discipline in state enterprises – co-operatives have become a natural scapegoat. Here, at least, is a cause in which party functionaries and workers can unite.

"We live in the trenches," complains Mr Rudenko. Taxation is arbitrary. In Leningrad, he claims, it is difficult to register new co-operatives and often impossible to obtain premises. Trading and purchasing co-operatives are not being registered at all in both Leningrad and Moscow, while in Moscow medical co-operatives have been closed down. In Uzbekistan all trade and purchasing co-operatives have been closed down.

It has been made difficult for co-operatives to withdraw money from their own accounts in state banks, says Mr Rudenko. They have even been put under strong moral pressure to pay lower wages.

In short, co-operatives stick out like a sore thumb. They were introduced into an economy (and society) that has no legitimate place for them. They enjoy no stable legal framework and suffer from arbitrary taxation. They find it almost impossible to obtain supplies from official sources and are correspondingly driven into the grey and black markets.

Expensive supplies must mean high prices at the point of sale. Yet huge profits can be made, given the scale of unmet demands. It is no wonder that co-operatives are labelled "profiteers" and have become closely associated in the public mind with the black marketeers and gangsters on whom they must often depend.

The world of the co-operatives is that of Joseph Heller's Catch 22: as an alien implant in the Soviet shortage economy, co-operatives must operate in the risky and expensive world of the grey economy; but, because of their inevitably high prices, the body politic rejects them still more firmly. Hovering on the boundary between legality and illegality, between legitimacy and persecution, the state of the co-operatives symbolises that of economic reform itself.

Martin Wolf

* *Anders Aslund, Gorbachev's Struggle for Economic Reform (Ithaca, New York: Cornell University Press, 1989)*

FINANCE

Banks' role in communist demonology makes their reform sensitive, writes **David Lascelles**

In search of greater financial discipline

REFORM of the Soviet banking system is one of the key elements of President Mikhail Gorbachev's drive for greater efficiency. He wants banks to help to introduce proper credit disciplines into the Soviet economy. But the task is immense, and the disciplines will only work if credit – like everything else – is given a proper price.

The reform is specially sensitive because of the high place that banks have always occupied in communist demonology. The state apparatus is also loth to hand financing power over to the banks. None the less, change is afoot, and banking legislation will be proposed quite soon.

"The aim is to introduce the classical banking structure of a market economy," says Mr Sergei Yegorov, the chairman of the Moscow Banking Union, the trade association for independent banks in the capital.

Traditionally, banking has been a state monopoly handled by Gosbank, the state bank. But it was not banking in the western sense, more a machine for doling out state investments. Two years ago, moves began to break this monopoly and introduce commercial banking.

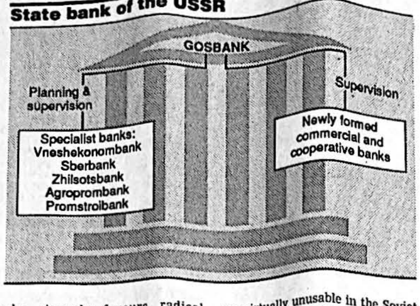
Gosbank pulled out of the financing business, handing over most of its lending and other functions to five specialised banks, Agroprombank for agriculture, Zhilsotsbank for municipal services, Promstroi Bank for industrial construction, Sberbank for personal savings, and Vneshekonombank for international banking.

At the same time, the establishment of independent banks was permitted, and these sprang up like mushrooms. Within 18 months, there were some 200 of them. They took three forms, so-called branch banks created and owned by large enterprises such as the automobile industry, co-operative banks, and innovation banks which are similar to western venture capital banks.

The hope is that the specialist banks will play a big role in gingering up the market by becoming universal banks and competing among each other western-style. Some of them may even be converted into joint stock banks with corporate shareholders.

But thus far their record has been disappointing. They have been accused of merely creating their own monopolies and adding even more bureaucracy to the banking system. And as far as Gosbank is concerned it represents a loss of monetary control because the banks still dole out huge amounts of loans according to ministerial diktat rather than applying proper credit judgments.

"We have not achieved much that is positive with the banking reform so far," admits Mr Victor Geraschenko, the chairman of Gosbank who strongly favours radical changes.



Sberbank with its Rbs340bn deposit mountain is also scheduled to play a more active role than in the past when it merely acted as a vacuum cleaner for savings to finance the government deficit.

However its 77,000 agencies are only 10 per cent automated, and its profitability is entirely at the mercy of whatever interest rates the authorities choose to set. Although it has joined Visa, its credit cards are virtually unusable in the Soviet Union, and there are only four cash machines in the entire country. None the less, the laborious process of training staff for a new era has begun, and small numbers are being sent abroad to learn the art of banking, in places like London.

The biggest changes have taken place in the commercial banking sector where several dozen new banks are now in business, 60 of them in Moscow alone.

The more successful have been able to take advantage of the enormous inefficiencies and distortions of the state system to accumulate clients and make good trading profits.

For example, the Commercial Bank for Innovations in Moscow reckons to provide a much wider and faster service than any state bank, according to its chairman Mr Mikhail Khodorkovsky. He arbitrages the Soviet Union's multiple deposit and internal currency markets to achieve dealing spreads that would make any western banker's mouth water.

Similarly, the Innovation Bank of Leningrad is able to raise deposits at 5-6 per cent and lend them out at 10 per cent, according to its deputy director, Mr Vladimir Pletnev, though like many new banks it also specialises in financing entrepreneurs, and providing other services like leasing.

The huge publicity which the commercial banks have enjoyed has probably exaggerated their importance. They still account for less than 2 per cent of total banking assets, though Leningrad bankers claim to have 11 per cent of commercial assets in their city. Many of them have also been derided as "pocket banks" because of their incestuous relationships with their owner/clients.

On the other hand, they are encouraging grass roots entrepreneurship, and fostering through their inter-bank activity the beginnings of a rouble money money market.

But good times will not be typical of life for commercial banks. At the moment they have little regulation or competition, and are also widely mistrusted for their inexperience and high loan charges.

"Now, commercial banks are taking the cream," says Mr Yegorov, "but they realise the golden times will pass." Last year they were also subjected to a 60 per cent tax rate which has made them complain furiously of discrimination.

The new package of banking legislation will come in two parts, one on the role of Gosbank and the other on the banking system itself. It will establish Gosbank as the Soviet central bank and supervisory authority, and will lay down capital requirements and other criteria for prudent banking, such as compulsory reserves. Auditing will also be tightened up.

More controversial is likely to be its provisions for interest rate control. The independent banks expect to have their freedom of action tightly curtailed by the law, particularly insofar as loan charges are concerned, though there may also be ceilings on deposits rates to prevent them competing too fiercely for funds against Sberbank.

But dramatic though all these changes are compared with as little as three years ago, there must be doubts over how far banking reform can go without fundamental parallel reforms elsewhere in the Soviet economy.

For instance, Agroprom, the agricultural bank, is carrying a huge portfolio of farming loans on which it can only charge 1 per cent. If it bumped up its rates, a large proportion of its borrowers would probably go bankrupt.

"This prevents us from introducing sound commercial banking on western lines tomorrow," says Mr Oleg Mozhaiskov, chief of the currency directory of Gosbank, who warns that the Finance Ministry will have to take over the burden of loan subsidies from the banking system if it is to do its job properly.

Whether all these changes will enable the Soviet Union to introduce an effective credit policy – the ultimate aim – remains to be seen. Gosbank will have to establish its independence from the Finance Ministry, interest rates will have to be set at realistic levels, and the whole banking system will have to be managed and supervised on commercial lines.

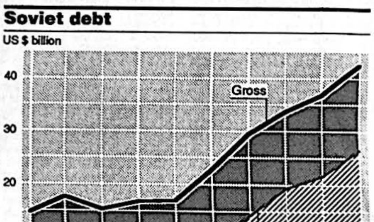
At the moment, the Soviet Union is so far away from all these goals that the prospects look distant, to put it mildly.

INTERNATIONAL BANKING

Wary look at Aladdin's cave

TRADITIONALLY, the Soviet Union has always enjoyed a high standing in the international financial community: it paid its debts on time, and its huge natural wealth gave comfort to its creditors. But that is beginning to change.

One reason is the predictable effect of the steady deterioration in the economy. External debts are mounting and strains are beginning to appear in Moscow's hard currency accounts. But another reason is the structural one of economic reform. Where borrowing was previously centred on Vneshtorgbank, the foreign trade bank, it has now been dispersed among dozens of Soviet ministries and enterprises, all of which have to be separately assessed by foreign lenders. Even Vneshekonombank, Vneshtorgbank's successor under the reforms, is not backed by state guarantee.



Fortunately for the Russians, their credit standing is sufficiently good to remain untinged by Third World-type worries. But the big question is just how much the Soviet Union will have to borrow to get its ramshackle economy back into shape. Who will lend it this money, at what price?

The Soviet debt is one area where glasnost has yet to penetrate fully. No official figures are available. But a Moscow trade journal reported last September that the gross hard currency debt was equivalent to about $44.7bn at the beginning of 1989, and this is not denied by Soviet banking officials. Indeed, they admit it has gone up since then.

This is not excessive for a country the size of Soviet Union, particularly since it has some offsetting deposits in western banks, and a large gold stock. More worrying is the annual servicing cost of $19bn at a time when the Soviet Union is running a hard currency trade deficit of more than $1bn a year.

According to the OECD, the Soviet Union's ratio of net debt to hard currency exports exceeded 100 per cent for the first time last year. Western bankers report increasing incidents of delayed payments, and all this is pushing up the Russians' cost of money in the market, with spreads on Soviet credits more than doubling. "The situation is becoming quite tight," admits Mr Victor Geraschenko, the chairman of the State Bank, partly because of additional grain purchases that have had to be made. But, he says, "the Council of Ministers is aware of the situation."

On the other hand, the Soviet Union clearly does not, at this point at any rate, see its salvation in massive external borrowing. This was ruled out by Mr Nikolai Ryzhkov, the Prime Minister, in January when he said: "The government is perfectly well aware of the heavy economic and political consequences of high foreign currency debts, and the debt, unfortunately, continues to grow."

As for opening up the country to direct foreign investment – another possible solution – that remains beyond the political pale. Mr Ivan Ivanov, deputy chairman of the State Committee on Foreign Economic Relations, which oversees the entire foreign trade system, says: "There are still very strong philosophical objections to that, to say nothing of technical obstacles. Let's wait and see."

For all these reasons, the role of western finance is expected to remain rather limited in the foreseeable future. Moscow's 43-strong foreign banking community is focusing on financing opportunities for very specific projects, preferably those with some kind of foreign currency generating content, while the Russians themselves wants more deals with non-recourse finance.

The decentralisation of foreign trade has been a complicating factor for foreign bankers, who have been cautious about dealing with unfamiliar entities whose credit standing is unclear. "We would have to look very carefully at the new banks," says Mr Richard Cole, the Midland Bank's representative in Moscow. The western governments' official export credit agencies are also having to decide whether to extend their guarantees to new names. So far only three, the Belgian, Italian and Spanish, are doing so on a regular basis.

Vneshekonombank, which regulates the foreign borrowings of Soviet enterprises, has been cautious about loosening the reins, knowing that decentralisation can quickly lead to matters getting out of control – as happened in China during the reforms in the mid-1980s.

So far, according to Mr Alexander Kolpakov, a general manager at the bank, it has only licensed 49 enterprises from thousands of applications. And all those are required to make it plain to their creditors that they have no state guarantees. "We have to be very cautious because of the inexperience of these enterprises," he says. On the other hand, the fact that they have been licensed is itself a comfort because it means they have official Soviet approval.

Foreign borrowing rights are also being withheld from the small new commercial banks which are springing up around the country, many of them itching to get involved in hard currency business. "None of them are equipped to deal in international markets," says mr Kolpakov. "Even we have a shortage of qualified staff."

For many enterprises, the only way to obtain currency is through the official auctions. But so far only two of these have been held, and the participants have been limited to the more important state-owned enterprises with the result that the amount of currency traded has been tiny. Although many experts are saying the auctions should be opened up, Vneshekonombank seems wary of making them too big too quickly.

One innovation was the creation last year of a new bank, Moscow International Bank as a joint venture between Vneshekonombank and six western banks. Although not yet up and running, the new bank will have borrowing rights and could become another important source of Soviet finance.

Eventually, the Soviet Union will get round to applying for membership of the International Monetary Fund, and following that the World Bank. Talks are only at the initial stage, but Soviet officials are already indicating that their motives are not simply to lay their hands on large new sources of finance. "If we join the IMF it will not be to open up an Aladdin's cave but to import external discipline," says Mr Geraschenko at the State Bank.

David Lascelles

Interview: Bakhytbek Baiseitov of Centerbank, Alma Ata

The spirit of enterprise

TWO YEARS ago Mr Bakhytbek Baiseitov was an official in Gosbank in Kazakhstan. Then along came the banking reforms, and he immediately seized the opportunity to become founder and president of the Alma Ata Central Co-operative Bank, or Centerbank as it prefers to be known.

Today, he is one of the Soviet Union's banking entrepreneurs. Youthful, dynamic, he is typical of the small but resourceful breed of young businessmen who have sprung out of the Soviet state machine at the merest hint of liberalisation. Operating from cramped offices in the Kazakh capital, he bustles around town in vans and jeeps, drumming up business, keeping customers happy, watching out for deals.

"The spirit of enterprise is very strong," he says. "Many people want to do it, but the opportunities are very small."

In some respects, he operates in a dream market. The state banking system is so inefficient that enterprise managers are thankful to switch their business to Centerbank even though its charges are high. And there are so many distortions in the system that bargains abound for those with a sharp eye.

On the other hand, Centerbank is still at the mercy of the state system for regulation, money transfers and taxation, all of which cramp its style. Also, the unpopularity of the co-operative sector to which two thirds of the bank's clients belong casts an element of uncertainty over the business.

Centerbank was registered in September 1988 and by last month had grown to have own funds of Rbs2.4m and total assets of Rbs45m. It has about 600 clients and employs 38 people. Its clients include organisations like Universal, a two-year old repair services co-operative, and a new restaurant specialising in Korean cuisine.

Although it provides standard banking services such as deposit-taking, lending and money transfers, Centerbank makes more than half its money from fee-generating business, such as advising on and financing joint ventures, consulting, and providing tax accounting services.

It also plays a venture capital role. Thus far it has invested about Rbs1m in six enterprises in auto repair, vegetable canning, tourism, football, trading and construction. Mr Baiseitov says he is also in the process of negotiating a joint venture in the advertising business with a German company.

To what extent Centerbank employs financial disciplines that would recognisable to capitalists is hard to judge. Mr Baiseitov himself admits that expertise is the one commodity he finds in shortest supply in trying to build the business.

He makes his credit decisions by classifying would-be borrowers in three ways: those whose credit standing is unquestioned either because of their strong backing or sound management, those which he knows less well but who still enjoy a good reputation, and those of doubtful standing. This is a far from perfect system, and he acknowledges that Centerbank already has some bad credits. "But we are a venture business," he says.

Mr Baiseitov is, not surprisingly, an enthusiast for economic reform. "We need proper relationships between enterprises, and with the right measures the Soviet economy could make a big jump forward," he says. But as a member of the Communist Party he also wants to see safeguards. "We need reform to stimulate private enterprise, but also a tax system that redistributes the wealth that is created."

David Lascelles

SOVIET UNION 13

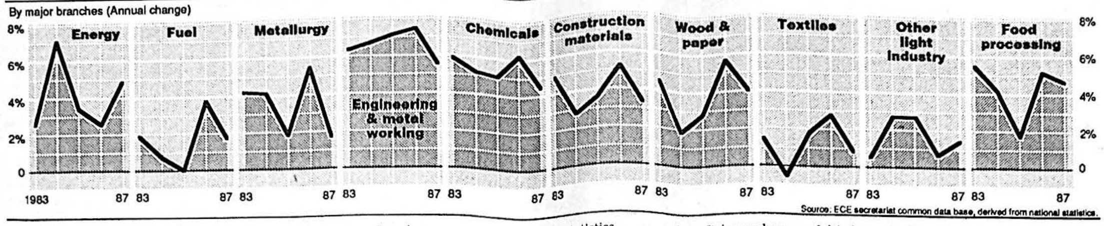
INDUSTRY

Industry must choose between obeying the ministries or the market, writes **Charles Leadbeater**

Enterprises torn between two masters

Gross industrial output

By major branches (Annual change)



Source: ECE secretariat common data base, derived from national statistics.

SOVIET industrial enterprises are caught between the ministries and the market as they enter the 1990s.

A transformation of the status and performance of Soviet industrial amalgamations has been at the heart of economic reform since 1987. In the past three years joint ventures have been encouraged to bring in foreign management and technology. Co-operatives are allowed to operate like quasi-private companies. But the centre-piece has been self financing at lumbering state enterprises to give them more responsibility for their performance and profits.

For instance in Belorussia only two of the 20 joint ventures signed have started production. Co-operatives contribute only 0.5 per cent of the industrial output of state enterprises.

Cost accounting is claimed to free the state from paying subsidies and to give enterprises limited commercial freedom. They can engage directly in foreign markets without going through foreign trade organisations. They can dispose of output in excess of the planned requirements, at negotiated prices. The weakening strictures of the plan should gradually mix with the incentives and disciplines of the market.

But this attempt to pursue economic reform through a grass roots transformation of Soviet industry has to be set in its wider economic context. Three Soviet economies are affected by the reforms.

First, there is the privileged planned economy. Defence, shipbuilding and machine tools, for instance, have a special status in the planning system. The state closely controls these sectors maintaining a degree of order and efficiency.

Second, the ordinary planned economy is a mixture of planning, markets and barter. Plans are often changed *ad hoc* and depend largely on bartering between enterprises and ministries. It is commonplace for enterprises to claim supplies well in excess of what they need. Skorahod, the Leningrad shoe amalgamation, has 30,000 sq m of storage space, almost as much as its main production area, to accommodate six months of stock in some lines because supplies are so uncertain.

But over-estimating supplies serves another purpose. For the third Soviet economy is a purely barter economy, in which supplies are paid for in kind rather than with money. It is independent, unregulated, unplanned and unaccounted for by state statistics.

This grey economy extends from the black market into the state sector in which, for instance, metal has become a currency. Vast inventories of metal are used to trade with other enterprises to procure scarce supplies. Enterprises are also increasingly paying their workers with services in kind, housing, cars, holidays and child care, rather than roubles which cannot be spent.

A large part of the Soviet economy is like a quasi-medieval economy, based on exchange of goods in kind, in an inefficient market, which operates without publicised prices. It is run by powerful industrial fiefdoms, rather than central planners.

What progress has cost accounting made in reforming both the planned and bartered economy?

Cost accounting is commonplace, with managers proudly proclaiming that they receive no subsidy from the state. But it falls well short of independence. Most output and supplies are set by state orders, which limit how much enterprises can produce. In sectors with acute consumer shortages state orders are likely to be increasingly important.

Self financing is largely just a bookkeeping exercise, as the costs and revenues which are being reconciled are so distorted. Prices neither reflect the costs of production, the balance of supply and demand nor world market prices. The accounts of self-financing enterprises are a labyrinth of hidden subsidies.

Enterprises freed from the embrace of the organisations which monopolised foreign trade are rushing into the export market to earn hard currency. To prevent this exacerbating shortages in the domestic market the state is limiting rights to conduct foreign trade. The Moscow Number One Watch Factory, which exports 80 per cent of its output, claims to be completely independent of the state. It estimates it could sell 200,000 watches a year in West Germany. But the state limits it to half that.

Reform has also disrupted long established supply chains, leaving some plants hanging in the air. Given the incentive of keeping more of their profit many consumer goods plants have acted as rational monopolists, switching to higher margin, more expensive lines. There are reports of plants simply resisting state orders so they can sell as much as possible into a domestic market beset by shortages.

Self financing, by disrupting lines of authority which kept relations between enterprises in ramshackle order, has provoked increasing industrial conflict, between enterprises, their customers and ministries. Viewed from industry, reform is essentially about how the monopolies which dominate the economy will be controlled and who will control them. Managers are keen to win as much control as possible.

Cost accounting seems to have created a dynamic for managers to start taking a more active, commercial approach to their enterprises. But this commercialisation is limited. Managers' support for different sorts of markets varies.

Cushioned by acute shortages in the domestic market, they want the freedom to set prices. Without that the incentive to invest and innovate, which has received a limited stimulation with cost-accounting, will remain miniscule. But lurking within most enterprises is the threat of a massive leap in the price level. Most believe prices would at least double without state price controls.

Most managers also want a labour market, to allow redundancies and more pay flexibility, as the disciplinary foundation for improving productivity and quality. But few are ready for the consequences: most enterprises say they could get rid of between 20 per cent and 30 per cent of their workforce.

They also want more freedom to sell into foreign markets. But few understand what it would mean to be integrated into an international division of labour or to meet shifting consumer demands.

Finally, enterprises are as lukewarm about a capital market, in which shareholders would exert discipline over managers, as they are about ministerial control. They want negative freedom from the state, rather than the positive freedom to become private property owners.

Given the years of stagnation and the economic jungle enterprises operate in, it is amazing how much some have achieved. In some areas – defence, watches, some textiles and machine tools – the Soviet Union can match world levels. It has a strong body of engineers, education is linked to industry and there is little if any cultural bias against working in industry. At some enterprises there is a genuine desire to use self financing to improve performance.

Within the domestic economy industrial fiefdoms are being formed around large enterprises. A plant's prosperity will depend on joining a survival network of powerful enterprises. The other escape route is to climb onto islands of economic efficiency, formed around foreign capital, with links to international markets. These could offer some protection from the sea of economic disorder which is developing around them.

Reform has set off a process of fragmentation and disintegration within the industrial economy, without yet offering a new market basis on which relationships might be reconstructed, discipline enforced, incentives provided and efficiency increased.

SECURITIES MARKET

Capital idea wins support

AS THE Soviet Union bubbles with new ideas for reviving its economy, few float more frequently to the surface than a securities market. But how realistic is that in a country where ownership is so firmly in state hands? On the other hand, few events would more dramatically highlight the country's determination to change than the re-opening of the Moscow Stock Exchange.

There are certainly few ideological objections to the idea: the government seems broadly in favour. The obstacles lie more in the immensity of the task of economic reform, particularly in the pricing of financial assets and the establishment of ownership rights.

Advocates of a securities market are to be found at the highest levels in the Kremlin. Professor Nikolai Petrakov, President Mikhail Gorbachev's personal economic adviser, argues that all state property should be transformed into shareholder property and traded on a stock exchange. Only that way, he thinks, can the Soviet Union's investment process become truly efficient.

"This shareholder form of property will make it possible to liberalise the investment process which is highly centralised and rigid," he says.

Another advocate is Mr Victor Geraschenko, chairman of the State Bank. "Why should private individuals not be able to buy shares in companies?" he asks. To those who worry about the polarisation of rich and poor, he points out that even in the US, the proportion of unearned to total personal income is only 17 per cent and falling. "Most Americans have their wealth in their houses, not in shares," he says.

The case for a securities market is twofold. From the point of view of the enterprises, their transformation into joint stock companies (for which a draft law is being prepared) would reinforce their independence from central control and, hopefully, sharply improve their performance. They would have to weigh the cost of finance, and deliver value to their shareholders.

A securities market would also play an important part in re-shaping the Soviet economy's price structure, which is why some specialists believe it is more important than trying to make the rouble convertible.

Advocates of a securities market are to be found at the highest levels in the Kremlin

From the investors' point of view, a market would give them somewhere to put money which currently sits idle in the State Savings Bank, adding to inflationary pressures. More than that, shares could also be used to provide employees with much-needed incentives to take an interest in their work.

But how would it be done? Could the choice state enterprises be privatised, UK-style? The names of Aeroflot and Intourist, both hard currency earners, have been suggested as possible starters.

But the truth is that few Soviet companies are presently ripe for privatisation. One senior party official even suggests that at least 20 per cent of them are technically bankrupt, and a greater proportion would not be able to survive the rigours of the free financial market.

Even if companies did not issue pure equity to start with, a stock market could be launched with them issuing debt securities. To this could be added trading in the growing stream of bonds which the government is being forced to issue to finance its budget deficit. So the foundations of a market could be created quite quickly.

Mr Petrakov sees an important role for the new commercial banks here. He says they could act like western investment banks, arranging securities issues, bringing them to market, and then trading in them to provide liquidity. Other people, though, point to the possible conflicts for banks who already have credit relationships with their clients. Mr Vladimir Milovidov, a financial services specialist at the Institute of World Economy and International Relations, says the Soviet Union might have to introduce a US-style Glass-Steagall Act to keep investment and commercial banking apart.

But mention of the words stock market is bound to send shivers down spines shaped by 70 years of communism. Mr Anatoli Milyukov, the deputy head of the Communist Party's social and economic department, and a securities market advocate, says: "The party must make clear that this does not mean a return to pre-revolutionary days."

David Lascelles

INDUSTRY

Charles Leadbeater on a consumer goods crisis which shows no sign of abating

Perestroika passes over the shops

MR YURI Aphinogenov had just about had enough.

It was Friday afternoon and the deputy director of Gostinyi Dvor, the largest department store in Leningrad, was exhausted from another week in what he describes as the Soviet Union's consumer goods war. "The clients treat us like the enemy," he says.

Mr Aphinogenov and the 3,000 staff who work in the 275 year-old store on Nevsky Prospect, the main shopping street, are at the sharp end of the extensive consumer goods shortages. The shortages are not merely an economic problem, they are vital to political stability.

Any government's legitimacy depends on satisfying consumers by delivering rising real incomes and standards of living. In the Soviet Union real incomes have risen but the standard of living is widely perceived to have fallen under perestroika, because production has failed woefully to keep pace with demand. Only those with unlimited access to hard currency can escape the crisis. Everyone lives within the confines of its stifling grip.

All the elements which have produced the consumer goods crisis are manifest through Gostinyi Dvor's arcades. Everyday 260,000 people tramp along Gostinyi Dvor's 18th century floorboards in search of products. But only between a third and a half buy anything. Mr Aphinogenov says: "The rest just look. It is amazing because there is practically nothing to look at. Everything is sold as soon as it comes in."

This demand is the product of strong wage rises in recent years, with the move to enterprise cost accounting which has allowed managers more discretion over pay. Professor Andrei Orlov, deputy chairman of the USSR state commission for economic reform, estimates that there are as little as Rbs0.18 worth of goods per rouble in circulation. In the first half of last year money incomes rose by 21.1 per cent while consumer goods production rose by 5.6 per cent.

The shortages are alarming. The Gostinyi Dvor television shop, which was full of products in 1978, now opens for just two hours a day because there is nothing to sell. Mr Aphinogenov says: "Last year we sold 15,000 televisions, we could have sold 150,000." He says shoes, clothes, children's wear and all electrical goods are always in short supply.

A recent official survey found that only 106 of 989 staple goods were in regular supply. In September last year retailers were short of orders worth Rbs8.4bn, including large quantities of washing machines, vacuum cleaners, fridges and wallpaper.

One cause is the chronic underinvestment in the light industry, the main consumer good sector. Although it produces 14 per cent of industrial output and about 37 per cent of consumer goods, it only accounts for 4 per cent of the asset base of Soviet industry.

Price comparisons

For state and market prices in Moscow (Roubles per kilogram)

	State	Market
Apples (green)	3.00	15.00
Apples (red)	3.00	8.00
Beef	2.50	12.00
Cabbage	0.16	3.00
Carrots	0.32	1.50
Cucumbers	8.50	15.00
Garlic	1.80	4.00
Grapes	4.00	15.00
Lamb	2.50	15.00
Mandarins	1.00	10.00
Onions	1.00	3.00
Pork	2.50	15.00
Potatoes	0.50	2.00
Tomatoes	3.00	15.00
Veal	2.50	15.00

(average ratio 5.6)

Source: FT Survey

To correct this, investment is being doubled to 1995 with the aim of almost tripling consumer goods production by the end of the decade.

But investment is only part of the problem. Mr Aphinogenov says: "Perestroika simply has not happened. Prices have gone up, quantities have gone down and quality has not improved at all."

The move to self-financing at manufacturing enterprises has severely disrupted supply chains to retailers. Profit seeking enterprises have rejected state orders for unprofitable production worth at least Rbs9bn. Clothing manufacturers are switching from unprofitable lines for old people and children to more expensive goods to tap the great reservoirs of unspent roubles. In the first half of 1988 the price of some new products and goods traded at contractural prices went up by at least 50 per cent.

Quality has also deteriorated under perestroika. In 1985 209,000 Soviet washing machines were repaired under guarantee. In 1988 the number rose to 369,000. In the same period the number of tape recorders repaired under guarantee rose from 931,000 to 1.19m, about one fifth of annual production. Some goods are of such low quality they cannot be sold even with widespread shortages. Mr Aphinogenov says: "With glasnost people have become more aware of western standards so they have become more choosy."

One of the favoured cures for state enterprises' poor production volumes and quality merely exacerbates the public shortage of goods. It is virtually impossible to motivate workers to produce more by paying them more roubles, which they know are virtually worthless because there is nothing to buy. Most state enterprises are now offering to short circuit the consumer market for their workers by providing them with preferential access to consumer goods at factory shops. Passage, a store which stands opposite Gostinyi Dvor, has started taking its new products direct to its supplier factories in an effort to persuade workers to produce above planned levels.

Other elements of the economic reforms have made little impact on the shortages. On joint ventures Mr Aphinogenov says: "Even when they are set up joint ventures will not want to supply state shops like this, they will want to sell through their own exclusive hard currency outlets."

Co-operatives contribute about Rbs30m to Gostinyi Dvor's Rbs450m a year turnover. But they too have their problems according to Mr Aphinogenov: "Their products are more fashionable but their prices are high and because they use the same equipment and raw materials as state enterprises their quality is still very low."

The government has embarked on a programme of converting defence and heavy industry production to consumer goods. These plants are meant to produce consumer goods equivalent in value to the amount they pay their workers in wages. This year defence conversion is meant to contribute Rbs15bn to a Rbs48bn increase in consumer goods production.

However, defence conversion faces considerable obstacles. In particular many enterprises which have been used to hefty research budgets and healthy profits from a cosy relationship with the defence ministries, are unwilling to risk lower returns from making fruit juice squeezers. Even though they have the cushion of working in a sellers market, many defence plants have found the switch to developing consumer products extremely difficult. Officials admit that at some plants conversion has been a disaster.

In large part the state's response to the crisis has been to back away from economic reform and recentralise control in an effort to kick start consumer goods production. Moves towards self-financing have been curtailed in some sectors to restrain wage and price rises.

State control certainly looms large in Mr Aphinogenov's work. Theoretically he can buy goods at wholesale markets. But as everything is in short supply they are distributed by ministries. Mr Aphinogenov says: "We are handcuffed. Because the consumer goods situation is so tense everyone wants to control us, the people's control committee, the workers' control committee, the trade union, the police, the Leningrad soviet, the ministries of retail trade." Three times a day the store is checked to make sure it is providing free clothes to refugees from Azerbaijan.

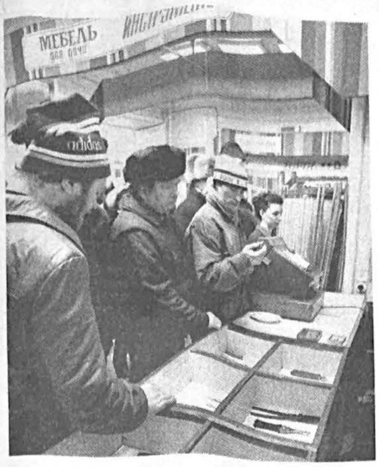
The Soviet consumer goods shortages, which have become more intense in the past five years, are socially and politically explosive. The consumer goods market is like an enormous centrifuge. The incessant search for goods, which disappear as soon as they are put on sale, is creating powerful pressures for social disintegration as people take increasingly desperate measures to protect their supplies.

The Leningrad authorities recently imposed a ban on all non-residents buying large quantities of goods in the city. Belorussia, which produces large quantities of the Soviet Union's fridges and televisions, wants to keep all the growth in output over the next few years for the republic's residents.

Everyone believes the black marketeers, the party and the retailers are working hand in glove to siphon off goods before they get to the shops. The move to self financing at manufacturing enterprises means that people reliant on cheap, low profit margin goods, such as children and pensioners, will lose out.

Co-operatives are vilified for charging high prices for filling the most profitable gaps in an economy dominated by monopolists. State enterprises are attempting to buy and barter their way out of the market to provide their workers with scarce goods. People carrying bags from joint venture shops are eyed with envy and resentment.

Lenin's great slogan for the Bolsheviks was socialism is soviet democracy plus electrification. If perestroika is to succeed its slogan will have to be: socialism is soviets plus televisions . . . cars, fridges, microwaves, stereos, videos and almost every conceivable item of clothing.



Tony Andrews

Waiting game: Long queues and empty shelves are a common site at many Moscow stores. Shop managers complain that they are "treated like the enemy" by angry customers

A glimpse of what's in store

PASSAGE, one of Leningrad's largest clothing shops, offers a glimpse of what might be in store for the Soviet consumer if reform is successful.

Like its near neighbour Gostinyi Dvor it suffers sharp shortages. Mr Gennady Serov, the director said: "Last year we sold Rbs40m worth of shoes, we could have sold Rbs400m worth at twice the price."

But while Gostinyi Dvor is a state shop, Passage was the first Leningrad retailer to move to self-financing. The difference this independence has made to Passage's ambitions is striking. While Gostinyi Dvor's management sees little alternative to labouring under pressure from consumers, ministries and monopolistic suppliers, Passage plans to transform retailing.

Passage was built in 1848 as an elegant, arched arcade. Mr Serov wants to return it to its former glory and exclusive social position, providing high quality goods as prices to match. The arcade will be refurbished for the first time for scores of years, and decked with palms.

In April the management will receive a report which should lead to the store's computerisation by the end of next year. At the moment, in common with most Soviet enterprises, everything is done on paper.

The management is discussing possible manufacturing joint ventures to stimulate production of high quality goods and to earn hard currency from exports with which it could import foreign goods. These will be sold at a special hard currency store it plans to open.

It is entering barter deals with foreign suppliers trading goods such as watches, lace and linen which can be sold abroad.

It also plans to set up a mail order shop in the store to allow customers to purchase foreign goods through Passage. The hard currency profit will be recycled to provide more foreign goods directly.

A "commercial shop" will be opened where goods in short supply would be bought from suppliers and sold to customers at unregulated market prices.

Mr Serov also wants to end the Soviet system of three queues per product which forces a customer to queue to choose an item, move to a second queue to pay for it and then return to the original queue to pick up the purchase. Already 54 per cent of Passage's sales are through self service.

Mr Serov says: "The queuing system is archaic. But unfortunately the store is designed for that system. If we did away with it in one fell swoop we simply could not maintain security."

However, even Passage holds out little prospect of a speedy improvement in customer service.

Mr Serov says: "When customers are baying for goods and they treat you as scapegoats for the consumer goods shortages it is very difficult to provide any decent service.

"Service will only improve when the shortages end and there is more choice, then people may need service and our staff will have the chance to provide it."

Charles Leadbeater

MANAGEMENT

In the steps of Mr Lee Iacocca

IF ECONOMIC reform is to succeed it will have to nuture constituencies of support not merely in the party and among academic economists, but amid the economy's grass roots. The attitude and skills of Soviet enterprise managers will be a vital factor. Is management a force for restructuring or an obstacle to it ?

Management as it would be recognised in the West hardly exists in the Soviet Union. It has been partly political, dealing with ministries and local party officials; and partly administrative, implementing decisions made higher up and very technically biased – most enterprise directors are engineers. Running an enterprise has been about making things work, within state controlled parameters.

Mr Nikolai Nikolsky, director of the recently formed independent Moscow Management School, says the most important complex Soviet managers suffer from is a fear of taking independent decisions. He says: "Our task is not to impart a vast body of knowledge. It is to change attitudes, to show them how they can guide a plant full of people, solve a range of problems, take independent initiatives to lead the enterprise rather than respond to orders from above."

Soviet managers seem eager for change. Mr Alexander Samsonov, director of the First Moscow Watch Factory and regarded as a conservative member of the Supreme Soviet, said: "We want freedom from all arbitrary interference from the state and a reasonable level of taxation. The management philosophy I favour is Mr Lee Iacocca's."

They want freedom to expand export markets and prices to be set by the market. They show no dislike for the profit motive. Mr Yesor Matchilsky, director of the Association of Business Co-operation commented: "Working for profit is far easier than living with the current reality."

There is a widespread desire for a labour market which would be the foundation for improving labour discipline, productivity and quality. Mr Nikolai Posysaev, head of foreign economic relations at the giant *Skorahod shoe manufacturing* amalgamation, said: "Workers know that if they are dismissed then can get another job at the same rate of pay. We still cannot pay enough to people who put in good work. Without a labour market we will not have a mechanism to improve quality."

On the face of it perestroika has unlocked managers' ambitions to develop their enterprises. Growing contact with foreign companies is opening new ideas about product development, technology and working practices. Whatever happens in debates about economic reform at the top seems to have created the beginnings of a managerial dynamic at the bottom.

But the desire for freedom is not necessarily reformist. For what is going on in Soviet industry is a struggle to work out how and who will control its monopolies. It is quite natural of monopolies to want as much freedom as possible to set their prices and output.

So while most managers support the market in general they are hazy about the role that private property and a capital market might play in enforcing managerial efficiency if state control is disbanded.

Even leasing enterprises from the state is problematic. Mr Yuri Chernichkin, deputy director of the Source brewery in Minsk, said: "We have to be very careful about leasing. Tax rates would have to come down considerably for it to be profitable, and we still rely on the ministries to help organise our supplies."

In such a monopolised economy marketing and advertising are still largely unknown and distrusted. One British company got some of its Soviet partners together to discuss how to market and advertise a new product. The general view was that if a product needed advertising it was not very good. If it was good it would sell anyway. The group decided they would form an association of USSR producers. "What is the point of that?" asked the British manager. "To stop anyone else making the product," came the reply.

Management education has started to respond to rising demand for new skills. Mr Nikolsky's school is one of about 100 which have sprung up across the USSR. It is targetted at managers under 35 years old who could be plant directors. It receives seven applicants for each of the 144 places available a year. Each place costs Rbs3,000.

The state system, in which enterprises have a strong role, is also changing. The Institute of Economic Science in Minsk, which teaches 5,000 full-time and 6,500 part-time students a year for future jobs in enterprise management, has introduced courses on international economics and electronics.

Leninist ideology still runs a *deep course through management. Even the latest Soviet* management text books start with Marx and end with rousing denunciations of bourgeois economists' criticisms of the Soviet price system.

Mr Ivan Lemachevsky, the young head of economics at the Minsk institute, explained that in spite of the changes the goal was still to prepare managers for a socialist economy. "It is an economy free from bureaucrats, exploitation, unearned income and labour alienation. The goals of 1917 are still relevant. We have to develop our own way, whatever variant develops will be based on the Leninist heritage."

Charles Leadbeater

JOINT VENTURES

In the realms of a fairy-tale

MR STEPHAN Pachikov, the director of the Paragraph computer software joint venture in Moscow, has some advice for foreign investors. "They should all read Lewis Carroll," he says. "This economy is like Alice in Wonderland."

Many of the joint ventures which have been formed over the past two years are more like entrepreneurial fairy tales than industrial realities.

Joint ventures, a key element in the economic reform programme, are meant to give Soviet enterprises access to the management expertise and technology of capitalist economies, to boost exports and ease industry's integration into the international economy. The policy commands the support of technocrats like Mr Nikolai Ryzhkov, the Prime Minister, as well as full-blown reformers, partly because it is not new.

The question hanging over joint ventures is whether they can go beyond the traditional approach, in which western management and technology were to be adapted in the name of perfecting socialism. Soviet enterprises need deeper relationships with foreign partners not just to fill in the technological gaps in their products and processes, but also to move from formal self-financing to a more thorough going commercialisation of their operations. The economy needs well rooted joint ventures because without them its role in the international industrial division of labour will remain largely confined to raw materials and low valued added goods.

The results of legislation since 1987 have not been impressive. According to the Association of Business Co-operation in Moscow, which organises joint ventures for a group of large Soviet enterprises, about 6 per cent of the 1,200 joint ventures registered are operating. About half of these are export oriented but many are simply legalised import-export operations.

Mr Yegor Matchilsky, the association's director general commented: "What have joint ventures brought us ? A few shoes, but that is about it."

As yet joint ventures form a very thin ring around the core of an economy which remains largely isolated. If they are to revitalise industry they will *have to succeed at enterprises* such as Skorahod, which runs the largest shoe factory in eastern Europe. It has signed five joint ventures, with six more under negotiation in an effort to improve its much lamented record for poor quality.

If joint ventures are to help improve the performance of the core they will have to achieve a double integration. First they will have to find a place within the international market and its division of labour. Second, they will have to be integrated into the rest of the Soviet economy. At the moment conflicting aims and cultures, inconsistent legislation and uncertainties over the repatriation of profits, make it difficult to achieve both.

Mr Matchilsky said: "Foreign investors mainly want to sell into the domestic market, but the government wants to push them towards exports. However, it is difficult to export to world levels using Soviet equipment and supplies."

Many joint ventures formed in the past two years are more like entrepreneurial fairy tales than industrial realities

Even if a joint venture wanted to use Soviet suppliers there is a problem. Their freedom from the system of state orders also means that they have no guarantees of supplies in an economy where the turbulence of reform is disrupting already creaking supply chains. Nor do they have the right to sell through Soviet shops. Thus joint ventures usually sell through their own exclusive outlets.

So joint ventures are encouraged not to integrate with the rest of the economy but to establish little industrial islands protected from the sea of inefficiency and state controls around them.

Mr Nikolai Posysaev, Skorahod's head of foreign economic relations, says the development of joint ventures has put managers under strain: "Three years ago we did not do any of this. It has required a lot of training. Managers' horizons have opened up but we still have problems to overcome."

But according to Mr Vladimir Tyurin, general director of *MCS, a computer assembly and distribution joint venture* between the Ministry of Merchant Marine and ICL, the British computer manufacturer, the problems are not all created by the Soviet side.

Mr Tyurin said: "Western managers do not trust their Soviet partners. They are just in for the short term to make a quick profit."

MCS is an unequal partnership he says because ICL makes a profit from final sales in the Soviet Union but also on the price it charges MCS to import the original kits.

Mr Tyurin said: "Foreigners think this is an underdeveloped market. ICL thinks it can sell its old technology here for a handsome price. But we could buy the elements of this ICL computer in South Korea at half the price. The British partner has to drop its imperial attitude or it will find this relationship will reach a dead end."

Mr Matchilsky concurred : "Many foreigners have not come up with the investment they promised. Quite a lot of companies want a stake in what is going on without investing anything in it."

To avoid this companies like Paragraph, the Moscow software house created six months ago, have sought a partner, which would provide start up finance and marketing in the West but little else.

However, establishing an international software house without a convertible rouble is easier said than done. The impressive team of software authors Mr Pachikov has assembled, could all be earning thousands of roubles a month as freelance programmers supplying Moscow's software black market.

Motivating them requires paying them in hard currency. But that is not allowed. So Mr Pachikov has had to devise two financial conjuring tricks to reward his staff. The company has opened a corporate account for each programmer, into which it pays 20-40 per cent of Paragraph's export earnings.

When the account accumulates more than $3,000 Paragraph gives the programmer a company Mastercard which he can use at Moscow's hard currency shops and restaurants. When the programmer goes abroad he is given the money from the account. When he declares it to the customs on his return it becomes his personal property.

Kompan, a Leningrad personal computer joint venture, has achieved a degree of internationalisation which is astounding given the isolationist traditions of Soviet industry. It is one of the best examples of how joint ventures could promote the modernisation of Soviet industry.

It was created at the end of 1988 by an agreement between the Academy of Sciences and a West German marketing company, ICF, which provided start up capital of Rbs63,000. Last year turnover per employee was $500,000 and this year it will build a $1.5m assembly plant where 38 workers could produce 80,000 computers a year, raising profitability by 45 per cent.

If ventures like Kompan are to become more common among traditional Soviet enterprises at least three changes will be needed. They are:

■ Western industrialists expect a wide ranging review of joint ventures this spring which could lead to a clear out of those where promised investment has not materialised. Industrialists expect this review, which will embrace tax and accountancy, may also start a shift away towards allowing foreigners to invest directly into Soviet enterprises.

■ Legislation, which has largely been based on sometimes vague and inconsistent decrees by Council of Ministers needs, to be rationalised and based on legislation passed by the Supreme Soviet to provide more stability.

■ Joint ventures are not a substitute for wider economic reform. They cannot be transplanted into an industrial system which works to a completely different rhythm. They will only bring benefits to Soviet industry if the economic system is opened up to them through further market oriented reforms.

Charles Leadbeater

TRADE UNIONS

A tough transition

THE EXAMPLE of Poland's Solidarity has been beguiling but confusing. It is the exception among trade union movements in the de-communising communist world: nothing like it has happened since, nor is likely to.

Indeed, even in Poland, Solidarity has not replaced the once-official union movement, OPZZ. The latter claims 6m members to Solidarity's 2m. Elsewhere the official unions are finding new leaderships, adopting newly confrontationist attitudes towards the state and enterprise management and employing new rhetoric.

But they are not in any serious way being eroded by "free" union movements. The unions look like one of the instruments of the old regime which can metamorphose into an interest group within the new, in part because they can express, and are already expressing, a working class distrustfulness of the intelligentsia and pro-marketeers who are in the leadership of change.

The Soviet All Union Council of Trade Unions (AUCTU), with 142m members in 32 branch unions, an income of Rbs4bn a year and formally the most powerful union movement in the world, will be part of this scheme of things. It has the organisation, resources and experience to make the transition from a body which transmitted management and party orders and provided social security, holiday and other benefits, to one which will habitually occupy the labour side of a negotiating table.

The shift will not be smooth, and rebellions are already evident. But the AUCTU is unlikely to lose a commanding place within the working class, even if it will increasingly have to adapt its structure and reflexes in order to co-opt those among the workers who will challenge this or that part of "the system", initially from the outside.

That is the task on which it is now engaged. The miners' strikes of last year threw up a new leadership which managed to wrest from the government huge concessions. Some of these leaders will, later this year, assume the leading posts in the official union of miners.

Yet the miners were not the first. In 1988, the fishermen's union had objected that the conditions of work of their members called for a new approach. The union sacked its old leadership and demanded more autonomy. Now, the baggage handlers want independence from the air workers union.

As the AUCTU's structure moves to accommodate new pressures from below, so it seeks to absorb the new pressures from above. From its Sixth Plenum in 1987, the union has been formally committed to independence from the Soviet state and the Communist Party. Now, as the party strips itself of exclusive power, it begins to look about for bargaining partners other than the Party.

Mr Yegor Yurgens is deputy head of the AUCTU's international department. He is one of the many youngish men you now meet about Moscow, clever, relativist in their views, dispassionate; a little like a policy analyst in New York or Paris, right down to the barbels tucked beneath his desk. This is his view: "We are getting closer and closer to traditional unions of the western type. We must see what these parties offer from the point of view of workers.

"We can go along with much of what perestroika offers. If perestroika is the democratisation of society, including industrial democracy, and is for more freedoms based on collective freedoms, then we are for it.

"Perestroika also means hard work. But other aspects look threatening – the emphasis on profits, for example, could mean a new Taylorism (disciplined repetitive labour) with no redress or control. We think the co-operatives will sooner or later have to go for profit maximisation, which will mean cuts in the now high salaries and a worsening of conditions. And they are not even taxed properly!"

Already, the unions are fighting on "issues" in a way they have not, or have not had to, before. Last month, a raise in the cost to enterprises of diesel fuel sparked off threats of strike as unions feared that the extra costs to the plants would come out of their members' wages funds.

The Finance Ministry backed down and promised to compensate the enterprises for the price rises one for one. It showed, again, how timorous this government is on challenging workforces – especially so soon before the republican elections. But that is the effect of democracy, on both sides.

Indeed, the unions' emergence as a "conservative" – that is, anti-market – force in society is wholly to be expected. It is not surprising that Soviet unions should, as democracy tries to take root, become like other union movements. They should now take lessons from the British Trade Union Congress and (in the case of the unofficial leaderships) the American AFL-CIO; and they should try to bully governments and enterprises (who must learn to bully back).

John Lloyd

Making labour work

THE quality and motivation of labour is one of the most endemic and intractable problems facing the Soviet economy.

Mr Alexander Samsonov, director of the tightly-run First Moscow Watch Factory, attributes much of the 68 per cent increase in labour productivity in the past three years to a reimposition of old fashioned labour discipline. But much remains to be done.

"Our people want hard currency but they do not understand what it means to belong to the international market. It needs a complete revolution in their consciousness. The main thing is just getting staff to work harder," he says.

In some areas productivity gains have to be won by reducing the industrial workforce. In Belorussia, for instance, industrial output has grown by 30 per cent in the past five years. For the first time this has been achieved with a decline in the industrial workforce of about 5 per cent.

However, there remains considerable disguised unemployment in the economy. Enterprise managers generally say they could get rid of between 20 per cent and 30 per cent of their workforce.

Most Soviet managers believe it will be impossible to instill more discipline, increase productivity and improve quality without a labour market.

But Mr Samsonov warned: "Our state has always provided for people. Now they are informed that their prospects are their own responsibility. People know that if we start to work like a western company there will be unemployment and they will not like it."

In spite of high-level criticism of "wage-levelling" and some early experiments, pay flexibility and differentials are limited.

Pay is still set around centralised norms, although in recent years works collectives have been pushing managers to use the limited freedom of self-financing to raise pay. This has partly fuelled the strong increases in real earnings which have exacerbated the consumer goods shortages.

Bonuses linked to plan fulfilment are an institutionalised part of the system which seem to have little impact on motivation. Joint ventures and co-operatives, which have more flexible pay scales, are whittling away at the system. Managers of state enterprises complain that co-operatives have poached skilled staff, most of whom go because of the prospect of making healthy profits.

The most significant change of recent years is the way enterprises have extended their role as providers of consumer goods and social services for their staff. Under self-financing, enterprises have been allowed to set up unregulated post-tax social funds, with which they purchase goods and services for their staff.

Charles Leadbeater

BELARUS TRACTOR PLANT

Slow starter

A BITING wind was driving snow into the faces of the workers hurrying from the Belarus tractor plant in Minsk. In the gathering twilight they trudged through the slush, leapt over enormous pools of muddy water in the plant's pot-holed roads, and dodged tractors ferrying parts between assembly lines. If this was the industrial vanguard of perestroika it looked bedraggled and dispirited.

For economic reform to succeed it has to be driven by engines of industrial efficiency. Judging by the Belarus plant, a classic Soviet factory, the industrial engines are ageing, cumbersome guzzlers of materials which are in constant danger of overheating.

The Belarus amalgamation, which was built in 1946 during the post war reconstruction of Minsk after the Nazi occupation which destroyed 80 per cent of the city, is a case study in the problems facing industrial modernisation. Judged by its yardstick very little has yet changed in the heart of Soviet industry and it will take several years of painful and costly restructuring to revitalise it.

The senior management team regards the reforms of the past few years with a measure of complacent confidence. Mr Georgi Katskevich, deputy director for commercial relations, candidly admits which a smile and a shrug: "The reforms have had very little impact on our operations."

The managers say the plant has been self-financing since 1978, freed from a lot of detailed state involvement in its affairs, enjoys strong export demand for its tractors and is committed to constant modernisation. Yet nothing is ever quite as it seems at a Soviet factory.

Belarus is one of the monopolies which dominate the economy. It is the only tractor manufacturer in Belorussia and it has a virtual monopoly in the USSR for the class of tractors it makes. Although it is self financing the state is deeply involved in its activities. State farms are obliged to buy its tractors. In spite of the Soviet Union's prodigious production of about 600,000 tractors a year, the management at Belarus estimate demand at twice that level.

This combination of monopolisation and consumer shortages creates an enormous obstacle to economic reform. Working within the security of a sellers market there is no competitive pressure on Belarus to improve efficiency. The only pressure comes from the state. So although self-financing is meant to bring more freedom in foreign trade, the plant's exports are limited to 23 per cent of the 100,000 tractors it makes a year.

Belarus is an old fashioned manufacturer. Most western companies now concentrate on excelling at designing and assembling manufactured goods, concentrating their activities on a small range of core technologies. Belarus makes tractors from start to finish. In the name of economies of scale it undertakes an array of activities, which western companies would contract out. The division of labour between enterprises is so under developed and ramshackle that Soviet factories are usually over-stretched and unwieldy.

There have been some moves towards simplifying its complex web of activities. Its engine plant was recently spun off to form a separate enterprise. Yet Mr Michael Korinchuk, the chief of the economic department, estimates the workforce of 25,000 could be cut by 30 per cent if the plant sub-contracted everything it need not do itself.

The threat of large scale redundancies also limits the plant's integration into the international division of labour. It is in discussions with Perkins, the engine manufacturer, over a joint venture.

The management says working practices are converging with the West. There is meant to be complete flexibility around the plant. It is aiming to create two grades of multi-skilled maintenance workers. In the past four years production has increased by 18 per cent entirely through higher productivity.

Managers admit that in the past three years there have been the first signs of labour unrest. One manager candidly admitted: "With our union set up it is relatively easy to dampen unrest. Who knows what would happen if we had an independent union like western plants."

During a decade in which western tractors makers have shed thousands of workers, employment at Belarus has declined by only 600 in the past four years. Like most Soviet factories there are a lot of people around. The 20,000 production staff work in a three-shift system to allow 24-hour a day production. Western automotive companies are only just attempting to introduce round the clock working. In the West the intention is to make extensive use of highly capital intensive plants. At Belarus the aim is just to keep pumping out tractors in an effort to overcome shortages.

The Dormash farm equipment machinery factory in Minsk — Tony Andrews

The relentless drive for quantity makes it difficult to ensure quality. Quality is controlled by statistical process control at the end of each sub-assembly, whereas in western factories it is increasingly being written into production workers' jobs.

The drive for quantity also limits opportunities to invest in new technology. In the past five years more than Rbs100m has been invested. The factory has more than 100 robots and automatic manipulating devices as well as computer aided design. A new plant is being built to make components for "tractors of a qualitatively new kind".

Yet the production technology still lags behind western plants. The pressure to maintain production means there is no summer shutdown for retooling and large-scale maintenance.

The cavernous final assembly hall houses what the management calls its two, fully automated, production lines. Under the old system parts were delivered to the lines by teams of tractors. With the recently automated line they arrive through an integrated system of conveyor belts, although tractors still ply back and forth carrying gear boxes. In western plants automation is just reaching final trim and assembly. At Belarus it is still much further upstream.

Deepening its involvement in western markets will be Belarus' salvation only at the cost of its crucifixion. Its integration into an international division of labour, to serve international markets, would demand a rationalisation of its activities, a new approach to marketing, quality and product development and thousands of redundancies which would raise the passions of its workforce at the cost of exacerbating domestic shortages.

In those circumstances it is easy to see why both workers and managers might prefer life as an unwieldy monopoly locked in the tense but secure embrace of its parent ministry.

Charles Leadbeater

PLANAR

Industry's rough cut gem

The Planar scientific and production amalgamation in Minsk, which develops and produces sophisticated machine tools is one of the rough cut gems of the Soviet economy.

It suffers many of the problems which afflict most Soviet enterprises, primarily that *commands from the more than 10 ministries* it deals with cut across the management's fledgling strategy for independence. But beneath that lies an enterprise with considerable potential.

All of Planar's output, and 50 per cent of its research is done to state orders and sold at prices which the state keeps at between a half and a third of world market levels. Planar's heavy spending on research and development, which accounts for about 15 per cent of its turnover, has been financed by the state rather than recouped in the price of its products. Thus all Planar's customers have been getting a disguised state subsidy in the price they pay for its machines.

Its move to self financing this year will only be successful if its prices are allowed to reflect the true costs of production.

The enterprise has also been hindered because state orders and the weakness of its suppliers has forced it into activities it would not normally undertake. Thus it has developed and produces 10,000 video cam*eras and television monitors* for use on computer controlled machine tools.

The management also bemoans the lack of a labour market, which is sees as the foundation for improving motivation and quality. Mr Gennadi Kushmev, a Planar plant director, estimates the company could get rid of between 25-30 per cent of its workforce.

Mr Yevgeni Onegin, Planar's director said : "Unemployment is a bad thing. But we already have enormous disguised unemployment in this country, with people doing jobs which do not really exist or people who are in jobs but who do not want to work."

Given these difficulties and the extremely weak incentives for innovation in the Soviet economy, Planar's achievements are impressive. Mr Vassili Zenkovich, the chief engineer, said: "If we were integrated into the international economic system we could get rid of a lot of peripheral activities and focus ourselves. But our isolation has meant we have had to be self sufficient. Western companies would find it very difficult to produce our machines in complete isolation."

Given the inadequacy of Soviet computers, the machinery, about a fifth of it to manufacture semi-conductors, is impressive. Planar has developed its own pneumatic, linear stepping motor which can move parts in at least six directions. Mr Onegin says only Japanese machine tool makers manufacture a comparable machine.

The bedrock of Planar's innovatory capacity is its strong links with local universities and its extensive training programme. About 20 per cent of the more than 10,000 employees are engineers.

It recruits about 60 graduates a year. Most of them will have been attached to the enterprise and engaged in practical work with it since the middle of their six years at university.

The test for Planar is whether its ethic of innovation and technical prowess can be matched by a commercial management which is able to focus the enterprise's activities so it could become a specialist *producer in the international market*. The management is professional and determined. It is drawing up a six-year corporate plan which envisages sweeping changes.

One of the main uncertainties facing the enterprise is the future structure of its ownership. The managers want a collective form of private property which would allow the workforce to own the plant through an employee share ownership scheme.

Yet if Planar is to be successful there will have to be large scale job cuts. It also wants to bring in foreign partners through joint-ventures.

Mr Onegin concluded: "We have to be integrated into the international economy. Serving customers must be easier than serving ministers."

Charles Leadbeater

MACHINE TOOLS

An ill-equipped hub

"INCREASING economic efficiency, carrying out the planned structural improvements, resolving social tasks, strengthening the country's defence capability and its international prestige and developing trade with foreign countries – all these major problems are pulled together into a single tight knot by the results of the restructuring of machine building."

Thus is was that in October 1986 Mr Lev Zaikov, CPSU secretary for the defence industry, set the scene for an ambitious attempt to overhaul the hub of Soviet industry – machine tool manufacturing.

The machine tool industry, which employs about 16m workers at more than 9,000 research institutes, design bureaus and production enterprises, is responsible for more than a quarter of the country's industrial output. From the outset it has been one of the main targets of economic perestroika.

When the 12th five year plan was released in March 1986 civil machine tool manufacturers were faced with a bewildering array of tasks: a 43 per cent increase in production over the five years, vastly improved product quality, the rapid development of more sophisticated computer controlled machinery, and the scrapping of its own outdated equipment to assimilate a surge of investment.

The entire tool kit of economic reform has been applied to the sector: centralised commands, administrative rationalisation, public exhortation and decentralisation of decision making to enterprises.

According to the most authoritative western study of the industry this melee of ends and means has generated considerable momentum for change at the price of industrial mayhem. The study, by Andrew and Bonnie Matosich,* says: "Machine builders are making headway in their efforts to improve productivity, reduce waste, produce higher quality goods, develop new equipment and requip their production base."

But the study continues: "The effect of many of these initiatives has been to threaten the sector's stability. By altering traditional objectives and priorities and severing long-established lines of authority and communication, the leadership has thrown machine building into chaos."

It all began with the plan's stringent targets. The 43 per cent increase in output had to be achieved with a reduction in metal consumption of between 12 per cent and 18 per cent and a 20-30 per cent increase in the utilisation of equipment. Half the industry's output had to be replaced with new models.

At the same time it had to retool: more than 60 per cent of the sector's own machinery was intended to be new by this year. Investment in the sector was due to rise by 80 per cent overall and by 250 per cent in plants producing precision instrument production.

By 1988 nearly 1,200 machine tool enterprises were covered by the Gospriemka quality control system introduced in January 1987.

This array of targets was to be transmitted through a rationalised bureaucracy, which reduced the number of machine tool ministries from 11 to eight, including the merger of the Ministry of Tractor and Agricultural Machine Building and the Ministry of Machine Building for Animal Husbandry and Fodder Production and the abolition of the Ministry of Machine Building for Light and Food Industry and Household Appliances.

This was combined with the creation of national inter-branch scientific and technical complexes to break down the ministerial barriers which have hindered innovation.

This administrative kick start was combined with decentralisation to enterprises in areas of foreign trade, pay and retained profits, which were meant to create a climate for continual modernisation.

The demands on enterprises to increase production, raise efficiency and improve quality, while pulling down antiquated production lines and taking on responsibility for foreign trade, has thrown the industry into turmoil.

The industry, which employs about 16m workers, is responsible for more than a quarter of the country's industrial output. From the outset it has been one of the main targets of economic perestroika

Ministers are still held publicly accountable for the performance of their ministries while being forbidden from directing day-to-day operations at enterprises. Enterprise managers have had new responsibilities placed upon them as they have had to cope with deep changes in the lines of communication and authority above them.

With the long established web of relationships between enterprises well and truly disrupted, and the press commenting on a *state of anxiety and despair in the industry*, the leadership in 1988 launched a campaign of public criticism. Penalties for late deliveries and poor quality were instrumental in plunging the sector almost Rbs4bn in debt between 1986 and 1988, making the transition to cost accounting that much more burdensome.

Yet the sometimes inconsistent package of reforms fell well short of introducing a more competitive market. With tight controls on prices still in place the monetary rewards for innovation and higher efficiency are still miniscule compared with the West.

State orders, rather than consumer preference still dominate the industry. Stankoimport, which is responsible for 90 per cent of machine tool imports estimates at least two thirds of its work still comes from state orders.

The outcome has been some improvement in the sector's performance. Production has risen by 24 per cent and the output of computer controlled machinery has risen by 37 per cent, says Stankoimport. The move to self-financing among the manufacturing enterprises which are the industry's customers has promoted more considered, innovative approaches to investment.

But the industry is still a long way from catching up with the West. Stankoimport estimates about 50 per cent of machine tools in the USSR are still manually controlled and a tour round any Soviet factory will confirm that some are ancient. The modern machinery suffers from a lack of sophisticated computers. Stankoimport officials admit the computer numeically controlled machines they sell abroad are relatively simple compared with many western machines. Mr Mikhail Yegorov, Stankoimport's deputy director general, says of the micro-electronics in Soviet machine tools: "They leave an awful lot to be desired."

Mr Yevgeni Filatovich, recently appointed to the newly created post of marketing director, says: "The industry is still used to responding to bulk orders from the state rather than individual customers. Attention to customer needs is poor, the product range is too limited and quality is too low."

In the past 18 months the leadership's attention has been diverted away from the sector by rising consumer shortages. Reform may be progressing at a slower but more sustainable and less disruptive pace.

This sweeping attempt to reform machine building yields two conclusions. First, Soviet industry is better off than it was under Brezhnev. Over the next decade machine tool manufacturers, with the growing involvement of western partners, will provide the rest of manufacturing industry with more reliable and technologically advanced equipment which should help to raise productivity.

Second, the modernisation *programme will probably fail to close the gap with the West* because it has left industry at a half-way house responding to both ministries and markets, pushed by commands and pulled by incentives, attempting to raise profitability with little discretion over costs or prices.

If the industry stays in its half-way house it could well succumb to a more efficient form of the stagnation of the 1970s. To leave the half-way house the reforms will have to push the industry further towards the market and its consumers.

Charles Leadbeater

**Soviet Economy Vol 4, No 2, 1988*

Charles Leadbeater unravels the bewilderingly complex method of accounting

Labyrinthine system in need of rethink

IF YOU find western accounts difficult to read, you had better draw a long breath before attempting to decipher a Soviet balance sheet.

Like so much else in the economy, accountancy has Leninist foundations. Yet if the economic reforms are to be successful, Soviet accounting will have to be transformed.

The principles of Soviet accounting have to be laid down by the planned economy. Profit has been less important than fulfilment of the plan's quantitative targets. Soviet enterprise accountants mainly satisfy ministries' demands for statistics rather than measuring the return on investment.

An accounting system designed to provide quantitative information, for centralised planning, has to become a system capable of providing financial information, for decentralised decisions based on profitability.

What are the problems foreign investors will face with Soviet accounts and what are the prospects for accounting reform?

The core of the profit and loss account of a Soviet enterprise will be sales, defined as cash received, against which are set a group of funds which record costs.

When Soviet managers talk of profit they usually mean "gross profit", that is cash received less salaries (the wages fund), the cost of materials and depreciation. This "gross profit" often sounds impressive but it is a long way from the final figure.

Bank interest, which is negligible, bad debt, losses through natural disasters and fines and penalties for breach of contract then have to be subtracted. The contributions to the reserve fund, which is designed to prevent an enterprise going bust, have to be subtracted as well as contributions to the investment fund. This yields a pre-tax profit.

The Soviet corporate taxation system is bewildering. Norms for tax rates in different branches of industry are set centrally but rates for enterprises appear to vary wildly according to profitability.

The post-tax profit is then consumed by further funds such as the pay bonus fund, the social fund, the workers' housing fund and so on.

There are several aspects of the average profit and loss account which will present problems for foreign companies.

Soviet managers complain they have only limited freedom to transfer money between funds. If the electricity fund is underspent it is difficult to boost another fund for materials. Thus millions of unused roubles are sloshing around in enterprise accounts forming a large share of repressed inflation.

Some of the funds, such as the reserve fund which is worth 25 per cent of authorised capital and the investment fund, are obligatory, although joint ventures may this year be allowed more discretion. Others such as the post-tax social welfare fund are discretionary. The more post-tax funds an enterprise has the lower the potential dividend for a foreign joint venture partner.

According to Mr Richard Lewis, of Ernst and Young the accountants, one of a small band of people who understand the details of both Soviet and western accounts, stocks are routinely overvalued. They are included at the full cost of production including fixed costs and administration, rather than the direct costs of production.

Depreciation is also tricky.

If the economic reforms are to be successful, Soviet accounting will have to be transformed

Depreciation in Soviet accounts is a purely bookkeeping exercise. What matters is amortisation according to norms laid down by Gosplan in 1974, covering everything from buildings to computers. Amortisation of investment is not done by correcting the value of fixed assets but usually by a transfer of cash to the amortisation fund. Amortisation rates tend to be very low. Once an asset is written off, amortisation continues to be paid to make up for the projected rise in the price of a replacement.

According to Mr Lewis this also means that the average balance sheet becomes nearly impenetrable. As amortisation rates are low, fixed assets tend to be systematically overvalued. Local enterprises will often put a high value on equipment foreign managers would regard as next to worthless.

Intangible assets, which have become controversial in the UK in the past year, pose their own problems in the Soviet Union. The Marxist labour theory of value, which says capital is the physical embodiment of past labour, found no place for intangible assets such as know-how. The category of intangible assets was only created in May 1988.

Establishing the initial equity base of an enterprise is also difficult according to Mr Lewis. This poses particular problems for joint ventures.

If a joint venture starts by purchasing fixed assets then the investment fund has to be debited. But as the venture has only just started there will be no money in the fund. So profits have to be used to fill up the fund, before they can be used for paying dividends. In practice most joint ventures either ignore or avoid this by taking the profit in the price the Soviet venture pays for supplies from the foreign partner.

Soviet accountants also have difficulties dealing with hard currency funds, according to Mr Lewis.

"Hard currency accounts for joint ventures were created after May 1988 but without guidance on how to use them Soviet accountants are largely clueless," he says.

If a foreign partner wants an independent accountant to examine a joint venture's books that right has to be written into the initial agreement. Independent accountancy is in its infancy in the Soviet Union. Inaudit, which describes itself as the only independent auditor, is 55 per cent owned by the Finance Ministry.

Three factors will determine whether Soviet accounting develops along lines more compatible with western accounts.

First, if joint ventures and enterprise self financing put down deeper roots this will force changes in accountancy. The accounting principles for joint ventures, which are likely to be revised this spring, have been the product of bargaining with the Finance Ministry and developing common practices, regardless of whether it is officially sanctioned.

Second, accountancy like everything else is the subject of a political struggle. For instance, the arcane issue of how to treat stock has split the Finance Ministry into two factions. One wants to limit western style accountancy principles to joint ventures, the other wants the system extended to all Soviet enterprises to hasten full cost accounting.

Third, an infrastructure of professional training and business services will have to develop before there could be independent auditing, and without independent auditing it will be difficult to introduce anything like a capital market or joint stock companies.

TAXATION OF CORPORATIONS

A pile them high policy

ACCORDING to Mr Vladimir Raevsky, deputy minister of finance, the taxation of Soviet state enterprises can vary between 2 per cent and 98 per cent of income. The ideological explanation for the variation in enterprise taxation is the Soviet prejudice against both failure and success. More important, however, is the conflict between the individual enterprises and branch ministries. The ministries are determined to keep enterprises as their branch plants by maintaining control over the money an enterprise earns.

The trick is to pile one highly variable and discretionary tax upon another. One such is the "special tax on capital assets". This tax is a substitute for interest and dividends in a western economy. The problem is that the rate of tax can vary between 0 per cent and 12 per cent of the value of the capital employed, increasing in steps of two percentage points. (While capital is taxed in this way, land is not, with taxation of land a purely local matter.)

Enterprises also pay Rbs300 per annum (£300 at the official exchange rate) for each production worker and Rbs600 (£600) for each person employed in administration. One aim of this tax is to decrease the top-heavy administration of Soviet enterprises.

After payment of taxes on capital assets and on employees, profits of the enterprise are divided between the state budget, the branch ministry and the enterprise itself. Taxation of profits is farmed out by the Ministry of Finance. It decides what each ministry will pay to the central budget and the branch ministries then determine the rates of tax that will cover their obligation.

Officially those rates depend on the profitability of each enterprise; in practice, the ministries decide what each enterprise should keep and the enterprises, for their part, try to resist their demands. Since enterprises that enjoy political influence can defeat ministries, smaller enterprises are often subject to a higher rate of tax than larger ones.

Enterprises are also liable to a tax on transport, to a turnover tax, which varies for every product and enterprise, and to payments to the social insurance fund. Not even depreciation belongs to the enterprise. A part goes to the relevant ministry and may be refunded at discretion.

Not surprisingly, this concatenation of taxes gives huge power to branch ministries. Failure to introduce a simple, non-discretionary system of corporate taxation makes the idea of "self-financing" a joke. Such a reform is now under consideration by the Ministry of Finance, with a non-discretionary progressive tax on profits as its aim. However flawed, the new system can hardly fail to be better than the present one.

Martin Wolf

AGRICULTURE

Farmers' woes

IF ANY single sector is critical to the immediate success or failure of President Mikhail Gorbachev's perestroika, it must be agriculture.

Food shortages have been the most acute issue fuelling public dissatisfaction, with widespread rationing of many basic commodities like meat and sugar. The huge food import bill, to pay for Soviet grain, meat and butter purchases, absorbs desperately needed hard currency income which might otherwise be used for consumer goods imports or industrial equipment.

Not only that. Agriculture is also the sector perhaps closest to Mr Gorbachev's heart. He made his name as a farming expert, first in his home region of Stavropol, then as the central committee secretary in charge back in Moscow. If anybody knows the problems, it is he.

It is all the more surprising, therefore, that the Soviet leader chose his colleague Mr Yegor Ligachev as the man to sort it out. He has no background in agriculture, although he has a reputation as an efficient administrator. More important, he is ideologically poles apart from his leader.

At the heart of Mr Gorbachev's attempts to overhaul the farm system is his vision that the peasant farmer must become "master of his own land". That immediately runs into the acutely sensitive ideological area of land tenure, on which Mr Ligachev is an open opponent of anything which smacks of private property.

The result is that the poor benighted collective farm worker, still known as a peasant in the Russian language, has to face a whole conflicting set of political signals in deciding how to respond to the upheaval of economic change.

At the same time the local rural bureaucracy, from the Communist Party officials to collective farm directors, have no incentive to promote reforms which would eventually put them out of their jobs.

The Land Law approved by the Supreme Soviet at the end of February promises a multiplicity of forms of land holding, including tenancies, leasehold, co-operative land, and the right to bequeath land to one's children – but no right to buy and sell land. However, the compromise has been furiously attacked by radical reformers.

Mr Ligachev sings a very different tune, in style if not in substance. For him, any change in land-holding is secondary, and the key issues are pumping more money and investment into the farms and the countryside, applying new technologies, building better storage facilities, and providing more tractors and trucks.

Meanwhile, Soviet agriculture continues to stagnate, with productivity far below international levels.

In 1989, the only significant increase in output was in sugar, up 11 per cent in response to the acute sugar shortage caused by illicit brewing of alcohol. Meat production, at 12.9m tonnes, was up less than one per cent. The same was true of butter and cheese. As for canned products, such as fruit and vegetables, their output actually fell by 3 per cent.

On the grain front the picture was slightly more hopeful, although only because grain production appears to have stabilised at an improved level: with a harvest approaching 210m tonnes last year, production has topped 200m tonnes for three of the past four years, ending years of wild fluctuation in output.

However, the harvest is still far below the plan target of 240m tonnes. In spite of the sorry record, the State Planning Committee has decreed that grain output will rise no less than 16 per cent this year. Many believe these targets are hopelessly optimistic.

Critics see the whole direction of agricultural planning as another manifestation of deep-seated bureaucratic resistance to any real farm reform.

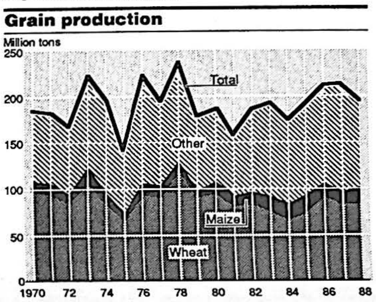
Mr Gorbachev has now brought in a real agricultural expert into the central committee, in the shape of Mr Yegor Stroyev, now a full secretary. He rejects the wholesale destruction of the collective farm system: the 13,000 loss-makers should not be closed, but transformed into co-operatives and leasehold tenure, he says.

Then he argues that price reform is now essential, not least because the return on grain production, for example, is less than half the return on grain-fed livestock. The result has been a sharp drop in sales of grain to the state, to the lowest level for 15 years, causing havoc to the bread and pasta producers.

Yet at the end of the day, the reformers say, no piecemeal change will have any significant effect until radical property reform, with the open introduction of private property, is allowed. Which all comes back to the key ideological question, on which Mr Gorbachev and Mr Ligachev appear to be hopelessly divided.

Quentin Peel

Grain production



Source: UN Economic Commission for Europe 1988/89

ENERGY

Steven Butler on the energy sector

The end of largesse

EVER since Lenin's famous dictum that communism equalled soviets plus electricity, energy has assumed an exaggerated role in the Soviet economy.

It is only now that Soviet economists, and indeed an important segment of the politically aware Soviet public, is seriously questioning the role of Soviet energy production, consumption and exports.

In the past 15 years, the Soviet energy industry has absorbed an amazing 70 per cent of the total growth in industrial investment, according to Mr Thane Gustafson, a consultant for Cambridge Energy Research Associates. As a result of this extraordinary effort, repeated predictions that Soviet oil production, in particular, had peaked have proved premature, sometimes wildly so. The industry has proved able to overcome repeated problems thrown at it by pouring more resources into the problem.

The Soviet Union is now the largest producer of oil in the world, at about 12.1m barrels a day last year, and the second largest exporter, after Saudi Arabia, at 3.9m b/d. Oil and gas exports account for more than 60 per cent of Soviet hard currency earnings.

At the same time, according to Mr Gustafson, the efficiency of Soviet energy consumption has actually declined as a ratio to gross domestic product, unlike virtually every other industrial economy.

One need only spend a winter day boiling in a Soviet apartment house, where there are no thermostats anywhere, to understand the vast potential scope for energy savings, although this would be unlikely to succeed without big price reform that would lift the cost of energy to more realistic levels.

In any case, the era of largesse which drove the enormous expansion of Soviet energy production appears to be reaching an end. Soviet economists and oil officials dismiss the idea that the industry is in crisis or that any immediate large drop in output will be seen, in spite of last year's fall in oil production from 624m tonnes to 607m tonnes.

"I don't think we are diminishing our volume of production," says Mr Lev Karpov, head of the economic department at the Institute of USA and Canada Studies. "This is the same as the old CIA forecasts," which wrongly predicted the Soviet Union would be an oil importer by 1985.

"If we reduce oil production," says Mr Gennadi Alpatov, head of the oil and gas division of the State Planning Commission for the Tyumen region, "it will be the result of planned investment decisions."

Mr Alpatov says this has not yet occured for the Tyumen region in western Siberia, which produces the majority of Soviet oil output. However, this year's freeze in investment in the region at 1989 levels implies a gradual decline in output because of the rising cost of bringing new fields onstream.

Moreover the sharpness of the energy policy debate along with rising pressure on the industry indicates that some fundamental change is inevitable. The idea that wholesale export of raw materials, such as oil and gas, is backward and undesirable has gained widespread currency in the Soviet Union.

This is, to a large extent, a naive view, containing elements of fear about stripping future generations of a vital resource as well as the idea that exporting resources puts the Soviet Union in a semi-colonial position.

Given the political climate, however, there is a real possibility that parliament will force a limit on oil and gas exports long before Soviet manufactured goods can compete in export markets.

A more sophisticated, and persuasive, form of the argument is put forth by economists such as Professor Alexander Arbatov, vice-chairman of the committee for productive forces and natural resources at the Soviet Academy of Sciences.

He calculates that the marginal cost of increasing Soviet oil output has risen sharply since 1985, and will climb by up to five times in the next decade. Although true cost calculations are impossible in the Soviet economy because prices are arbitrary, the idea that previous failure to include necessary infrastructural costs has meant the oil industry is a far bigger drain on the economy than anyone has suspected is gaining currency.

Professor Arbatov believes it would be appropriate to allow oil production to decline to a range of between 560m and 580m tonnes. "In the 1990s," he says, "some decrease in production will continue no matter how much we invest." This would affect exports and hard-currency earnings, although in the long run he believes the Soviet Union could more effectively concentrate on other export areas.

As a corollary to this, however, he believes that much western technology imports could be cut because they often cannot be effectively used, and that there is vast scope for energy conservation. This he admits, however, depends on a much broader reform in the economy at large that goes far beyond energy policy.

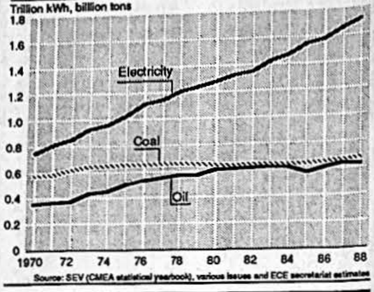
Indeed, Professor Arbatov has argued that excessive investment in energy-intensive producer goods and raw materials sectors has led to wasted industrial production amounting to 25 per cent of GNP, while others have argued that the scope for energy savings could be as much as one-third of consumption.

These are stunning figures. Yet the alternative to conservation is to allow future energy investments to take up an even larger portion of industrial investment, since energy consumption has grown faster than economic output. This would effectively neuter the programme to restructure the economy and produce more consumer goods.

The pressures on energy supply are also not confined to the oil sector. This year Armenia has experienced severe power shortages because of the closure of nuclear plants following the earthquake. Indeed the entire nuclear programme is in jeopardy, as reactors that are planned or under construction have been scrapped.

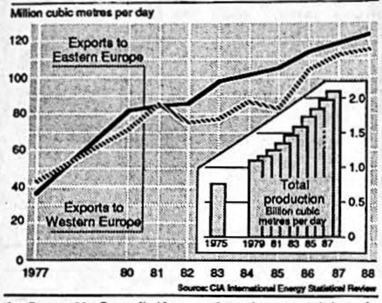
Between gas, coal, and water resources, there is certainly no shortage of primary energy sources in the country. Yet the costs and environmental difficulties posed by expansion on the scale required to maintain the current industrial structure is more than enough to convince many Soviet economists that it is simply not worth it.

Energy production



Source: SEV (CMEA statistical yearbook), various issues and ECE secretariat estimates

Natural gas trade



Source: CIA International Energy Statistical Review

MR OLEG Sarukhanov, deputy mayor of Surgut, slapped his telescopic pointer against a large relief map of the city mounted on the wall.

"Mr Butler, until now this map has been classified. You are the first foreigner ever to see it," he said, gesturing with his hands.

I hastily suppressed a guffaw when it dawned on me that the deputy mayor was not joking. His opening gambit was instead the first step in an elaborate presentation aimed at impressing on me the attractions of investing in Surgut. After all, is not the Financial Times a vehicle to broadcast just such a message?

Surgut is a new Siberian city, an oil town with a huge gas-fired thermal power complex. Settlers first came to this spot on the banks of the River Ob nearly 400 years ago, but Surgut became a city only 25 years ago. A population of 100,000 in 1977 has soared to 256,000 today, and plans are afoot to accommodate 500,000 people by 2000.

This population, Mr Sarukhanov says, will be buoyed by a joint venture petrochemical complex planned for the outskirts of the city. He wants to find foreign investors to help build a hotel and an international airport at Surgut, on the theory that cargo aircraft flying from Tokyo to London can accommodate heavier loads by stopping to refuel at Surgut

Hype aside, Surgut lies in the midst of one of the most productive and prospective oil provinces in the world. Western Siberia produces more than 60 per cent of the Soviet Union's oil output of 607m tonnes, and Surgutneftegas (Surgut Oil and Gas) produces 50m tonnes, about 1m barrels a day.

A map of the area shows a concentration of oil and gas reservoirs in the immediate vicinity of Surgut, becoming more sparse as the distance from the city increases. Soviet geologists believe this represents principally the greater intensity of exploration efforts near Surgut. The 3.5bn barrel Feodorovsk field lies on the outskirts of the city and is currently in a declining phase with production aided by gas lift and water injection.

Engineers are now making plans to develop the Tianovskoje field, 300km north of the city with preliminary recoverable reserve estimates of nearly 1.5bn barrels. "This is a huge territory and our grandchildren will still have some place to work," says Mr Nikolai Medvedev, deputy general director for geology at Surgutneftegas.

Oilfield development in the area has been an important technological achievement because of the severe cold in winter and the swampy conditions that require fields to be built on artificial islands. Western oil companies believe the industry is extremely inefficient compared with industry standard practices in the West, and that western technology and mangement practices could produce more oil and reduce costs by a large factor.

Oleg Sarukhanov: hopes to attract foreign investors to help build an international airport in the Siberian city of Surgut

SURGUT

A message for foreign investors

They may soon have a chance to prove this should joint venture oil projects currently under discussion with the Ministry of Geology succeed. In the meantime, the oil industry is adjusting to a new era of perestroika, in which local authorities have been given more autonomy under the "self-financing" principle.

In spite of some cries of alarm as change swept through the industry last year, Mr Gennadi Alpatov, head of the oil and gas division of the State Planning Commission for the Tyumen region, denies the industry is in any crisis. He says investment funds are stable and that output is to be maintained.

Like other enterprises throughout the Soviet Union, Surgutneftegas is using its new independence to find ways of keeping the workforce happy. The enterprise, which employs 30,000, now receives 5 per cent of its income from oil sales in hard currency.

Mr Nikolai Spirin, manager of the Feodorovsk field gas lift production plants, is also the man with the happy chore of disposing of some of this money. Mr Spirin has $3m with which he intends to buy video equipment to sell in roubles to the workforce.

Mr Sarukhanov claims that the housing and supply situation in Surgut has improved in recent years. And the city has been busy building hospitals, schools and recreation facilities. Primitive living conditions have been a constant problem in the oil regions of Siberia. Pay levels at more than twice the average wages in central Russia make little difference if there is nothing to buy and nowhere to live. This has led to high staff turnover.

Certainly all of these problems have not been resolved. At a meeting of ministers held in Surgut in February it was decided to allow Surgut to market directly 1m tonnes of oil this year. With this oil, Surgut will attempt to solve its meat supply problem. Precisely how this will be accomplished had not been decided, but most likely Surgut will export the oil for hard currency and proceed from there. Local officials blame a worsening of the meat supply situation on the moves towards independence by the Baltic republics.

Indeed, in full knowledge of the value that local oil and gas production holds for the state, and its lowly price in the Soviet economic system, throughout Siberia there is a powerful political call for price reform coupled with fiscal decentralisation that would give local authorities control over oil revenues.

Mr Sarukhanov complains that even with the current low prices for crude oil and electricity, Surgut only gets back in spending allocations some 50 per cent of what it remits to the central government. Given oil's critical role as the principal earner of foreign currency, this call is likely to be resisted to the end.

Steven Butler

PETROCHEMICALS INDUSTRY

Year of big setbacks

THE PAST year has seen a vast scaling back of expectations in the Soviet petrochemicals industry, in which a series of huge joint venture projects have been cancelled or postponed.

The shelving of projects at Uvat, Nizhnevartovsk, Novyi and Urengoi, site of the gigantic natural gas field, was announced in mid-1989, while the $5bn polypropylene and polyethylene project in Tenghiz was postponed indefinitely at the year end.

The projects were to help reduce Soviet dependence on imported chemicals, presently totalling about $4bn a year, and were consistent with current ideas about processing raw materials at home. However, there has been concern about how the projects would be paid for.

There were also worries about the environment and over whether the plans were consistent with a broad shift in investment priorities to consumer goods industries.

Western involvement in the projects is critical because the Soviets lack the technology that would be needed to cope with pressure brought by its budding environmental movement.

This pressure is a real concern on the minds of Soviet officials and could have a big impact on future plans.

In the past year a series of huge joint venture projects have been cancelled or postponed

The only joint venture project which has definitely survived is in Tobolsk, western Siberia. Contracts for the project, which will be 15 per cent owned by western partners, were signed at the end of November between Tobolsk Petrochemical, under the Ministry of Chemical and Oil Refining Industry, and Combustion Engineering of the US and Neste of Finland.

McDermott, of the US, had been involved in negotiations throughout the project but dropped out in the end. Mitsuis and Mitsubishi are understood to have taken taken interests.

The Japanese government would certainly frown on large scale Japanese participation in such a project, because of Tokyo's outstanding territorial dispute with Moscow.

The first phase of the Tobolsk project is to cost $2bn and is scheduled for completion in 1993. Combustion Engineering will mange the project, while Neste will handle marketing of the products worldwide in order to satisfy hard currency obligations. Products will include propylene and thermoplastic elastomers.

A second western Siberian project at Surgut is still at the study and discussion stage, but at least has not been cancelled. Local authorities in Surgut are anxious still to attract more partners to the project to ensure its viability.

Neste said it was interested in participating and Combustion Engineering is also thought to be involved, but final negotiations for a contract have not yet begun.

The Tobolsk project will result in expansion of an existing petrochemicals plant, but Surgut is a greenfield site, with a processing capacity of 3m tonnes a year, to be onstream in 1996, and a second phase of similar size, costing Rbs5.6bn by 2000.

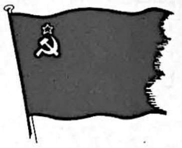
The Surgut project is aimed at using some 15bn cu m a year of casinghead gas produced in the big oilfields in the area which is currently burned off at the wellhead for lack of a market.

In that sense, the location of the plant makes a good deal of sense. However, planners have had to contend with increasing concerns about environmental impact in an area that has already been chewed up by the oil industry.

The planned site for the plant has already been moved further to the west of the city, and it remains to be seen whether even there it will receive final approval.

Steven Butler

ENERGY



OIL SECTOR

Poor transport stalls industry's progress

PERESTROIKA has stuck the Soviet oil industry, which last year saw output decline from a peak sustained for two years at 624m tonnes to 605m tonnes. The industry fell victim to many of the broader ills facing the Soviet economy, in particular transportation breakdowns, both on the railroads and in the air. This affected the supply of oilfield equipment and the shipping of oil products.

The giant refinery at Omsk, for example, was forced to shut down when its storage tanks filled up following troubles on the rails and this would have affected the oil fields which supply it. The industry is also facing a continuing uphill struggle just to maintain production as older fields decline. This requires rising investment just to stay in place.

However, these difficulties need to be kept in perspective. Any industry operating at capacity is bound to face temporary difficulties – UK oil production last year fell by more than 25 per cent, compared with about 2.5 per cent for the Soviet Union. Domestic consumption as well as exports absorbed the decline, in about equal proportion.

The pattern of Soviet exports is certain to change as trade among Comecon countries moves to a hard currency basis

However, Soviet oil officials deny that any big cuts in exports will take place this year, as is widely expected in the West, and say they expect exports to stay in the range of 170m-180m tonnes. In the first months of the year oil deliveries have been cut to most eastern European countries.

Soviet officials say the cuts result from railroad congestion and will be made up for with extra deliveries later in the year. There is none the less a suspicion among some observers that the Soviets are in reality diverting exports to the West to increase hard currency earnings.

Even if this is not true this year, the pattern of Soviet exports is certain to change as trade among Comecon countries moves to a hard currency basis. It is unclear whether this will result in a larger net market for Opec or other crudes, as some predict.

It could cause a larger proportion of Soviet oil to find its way to the West. Scope for conservation in all these economies is vast, and the volume of oil available for export depends both on the speed of economic growth and the speed with which the Soviet Union substitutes gas for oil burning.

The actual performance of the industry may prove more difficult to predict than in past years because of decentralisation to the producing enterprises. They have now been given rights to dispose of part of their production, and Soyuznefteexport, the oil export concern, now handles exports for these companies on a fee-for-service basis. And, of course, output would decline if investment is kept level or cut, as is under consideration.

Western oil companies may eventually become a source of significant investment in the Soviet oil industry. While virtually every large western oil company is in discussions with the Soviets over exploration and production joint ventures, a good deal of hard negotiations lie ahead before any of these deals are consumated.

The Soviet Union offers some of the most attractive under-explored acreage in the world, and western technology could give a badly needed boost to the industry. The potential means that no large oil company can afford to stay away, but none will want to plunge in with big capital commitments until the many political and other uncertainties are cleared away.

Restructuring of the industry last year produced complaints from some senior officials that oil production was in disarray. However, these complaints now appear to have been premature. In the medium term the industry is bound to be affected by the turmoil in Azerbaijan, where 60 per cent of the oilfield equipment industry is located. Officials say this will slow the development of new fields, although the Ministry of Oil and Gas is transferring production of some of the equipment industry to former military factories in central Russia, which should eventually make up for the shortfall.

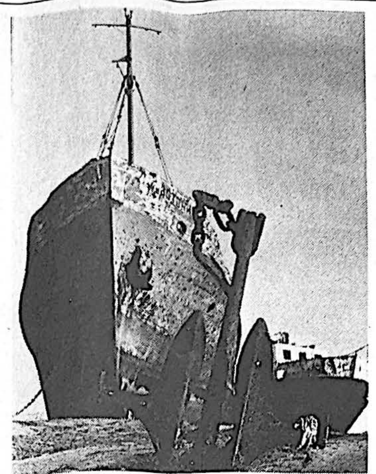
Gas production continued to rise, although at 3 per cent this is slower than in previous years. The Soviets appear intent on lifting gas production from 796bn cu m last year to 1,000bn cu m by 2000, and are embarking on an ambitious programme of domestic pipeline construction. However, they have adopted a relaxed attitude towards growth in exports, perhaps because of vigorous political opposition to the export of raw materials.

Neither Soyuzgasexport, the gas export agency, nor gas producing enterprises have indicated any intention to take advantage of rapidly growing demand for gas in Europe, although they are aware of the trend to use more gas in power generation. This could come as a shock to western Europe, where many analysts believe fresh supplies will have to be made by the middle of the next decade. The time needed for new gas projects to materialise makes it unlikely the Soviets will be the source of this new supply.

The industry fell victim to many of the broader ills facing the economy, in particular transportation breakdowns

The move to hard currency trade among Comecon countries looks almost certain eventually to reduce the Soviet Union's share of sales to eastern Europe, since those countries are not locked into long-term contracts. Some countries have begun negotiations with Algeria for imports on a countertrade basis.

Steven Butler



Washed up: The huge Aral Sea, once the world's fourth largest inland water, has effectively ceased to exist, thanks to the effects of massive and thoughtless irrigation schemes

ENVIRONMENT

Rescuing the poisoned earth

THE SOVIET Union is in the throes of an ecological crisis, compared with which most other global pollution problems pale into insignificance.

Virtually wherever you go in the country, evidence of environmental catastrophe is glaring. From the gleaming white sands of Riga Strand on the Baltic Sea, where bathing is banned because of chemical waste and raw sewage, to the lower reaches of the Volga river, where the sturgeon are floating belly-up in shoals before they can spawn their precious caviar, the contamination affects every form of life.

The huge Aral Sea, once the world's fourth largest inland water, has effectively ceased to exist. It is now two shrunken, salt-poisoned pools in the desert, thanks to the effects of massive and thoughtless irrigation schemes.

The last fish died around 1983, local officials say. Child mortality around its shores is as high as one in 10 because of poisoned drinking water from uncontrolled use of pesticides on the region's mono-culture cotton crop.

In the words of an official report from the Supreme Soviet last November, its rescue is "virtually beyond the control of man." If rescue is possible, it could easily cost Rbs60bn, Soviet ecologists believe.

In the republic of Belorussia, one quarter of all the arable land has been destroyed by the fall-out from the Chernobyl disaster – contaminated with Caesium 137, which will last for decades to come.

Even in Siberia, where man is only an occasional visitor, the extent of the destruction is already horrifying. The oil and gas industries have laid waste some 6m hectares of the fragile Yamal peninsula, taking with it most of the survival hopes of the indigenous population. In another example, an estimated 770 sq m of forest around the nickel works at Monchegorsk, in the remote Kola peninsula, have been destroyed by sulphur emissions.

The ecological crisis is not only wreaking a terrible environmental and health toll on the Soviet population. It represents arguably one of the biggest political challenges to the ruling Communist Party. It amounts to a crippling economic burden on an economy already in dire straits. And almost certainly it represents an international calamity which will require a global solution.

"The most serious problem is in fact the economic system," says academician Mr Alexei Yablokov, the marine biologist who has fought for years to make his own government aware of the crisis. "That's the main cause of our ecological and environmental disaster."

All the decision-making comes from the centre – from the government, the ministries, and the Communist Party, he said. "The central committee (of the party) decides what sort of factory is built where.

"All the ministries are full of people with the old thinking – more and more production, whatever the price. Their aim is not human happiness, but more production."

The ecological crisis is not only wreaking a terrible environmental and health toll on the Soviet population. It represents arguably one of the biggest political challenges to the ruling Communist Party

To stop the deterioration in the environment, Mr Yablokov said, "we need to change the mind of the government. That is practically impossible. It may be easier to change the government."

The popular reaction to years of arrogant government disregard for the environmental, consequences of crash industrialisation and agricultural mega-projects has been to call a virtual halt to all new investment schemes. Seven nuclear power stations have now been abandoned in mid-construction in the USSR post-Chernobyl – more than anywhere else in Europe.

At least 100 factories have been stopped for ecological reasons, including the huge natural gas processing plant in Astrakhan – the cause of the sturgeon kills on the Volga.

The absence of any trusted institution offering popular involvement in the planning process has meant a switch from ignoring local sensitivities, to subserviently following them.

The Green movement has developed rapidly across the country. Environmental issues have been second only to food shortages as an issue in the latest election campaign – causing the demise of a string of top regional party leaders in areas like Tyumen (the big oil-producing region of Siberia). A Green party already exists in each of the Baltic republics. Greens were founders of the nationalist movements in Estonia, Latvia and Lithuania. Mr Yablokov believes it would rapidly pick up 4m-6m members across the country (the Communist Party has 20m, with all its monopoly of power).

Mr Nikolai Vorontsov, chairman of the State Environment Protection Committee, needs the Greens to fight the bureaucrats. He has the distinction of being the only non-communist in the top ranks of the government, and a minister who had to be bullied and cajoled into accepting his position.

"We haven't had a case in our history where a minister has been sacked for polluting the environment," he says. "There are plenty who have been dismissed for not fulfilling the Plan. The Plan does not require them to use clean equipment."

He believes that the technocrats are still more powerful than the Greens, and agrees that the Plan itself has been "an environmental monster." A lifelong environmental campaigner, Mr Vorontsov says he regards "with horror" the full extent of the problems he has to deal with.

"I am responsible for one-sixth of the earth's surface, polluted and non-polluted." He stands in front of a huge map on his office wall, and spells out the greatest disaster areas from the top:

- chronic overfishing in the Barents Sea;
- man-made pollution of the Baltic Sea and Gulf of Finland, to which all the Baltic state contribute;
- the radiation contamination in Belorussia;
- industrial pollution in the Eastern Ukraine, combining the worst effects of coal-mining and the whole complex of iron, steel, chemical and metallurgy industries;
- destruction of the Azov Sea, through salinity, overfishing, and industrial pollution;
- the death of the Black Sea, 70 per cent caused by pollution from the Danube, with a "dead water" layer at the bottom of the sea which is now only 70m from the surface;
- the loss of the Aral Sea;
- massive industrial pollution around all the big cities of the Urals;
- chemical and metallurgical pollution in the Kuzbas coalfield of Western Siberia;
- destruction of the fragile Arctic eco-systems in the Yamal peninsula and elsewhere.

He could have mentioned easily a dozen more.

The Supreme Soviet, browbeaten not least by Mr Yablokov, approved last December the first steps of an environmental action plan.

It includes a ban on state funding for projects without ecological clearance from Mr Vorontsov's committee, new legislation for crisis areas, and increased fines for polluters.

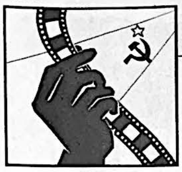
Yet the scale of the task is truly daunting. On current trends, the situation will continue to deteriorate until 2000. To stabilise it in the next two to three years, and then begin to repair the damage, would cost between Rbs230bn and Rbs350bn, Mr Yablokov believes. He does not know where the money can come from.

Perhaps even more of a challenge is the need for a complete change in psychology about the environment.

"Communist ideology puts man at the centre of the universe," Mr Vorontsov says.

"Everything is done for the sake of man. But we forgot the part of the biosphere. Its resources are limited. We must change that anthropocentric thinking for biospheric thinking. It needs a complete change in vision. It is a psychological switch comparable to the trauma of changing from Ptolemy's view of the universe, to that of Copernicus."

Quentin Peel



CINEMA

Film makers are still obsessed with the past, writes **Paul Winfrey**

A mystery worthy of the screen

EVERY MORNING, Tolik awakes to the piercing sound of a recurring nightmare. In his dream, he pictures the famous battleship, Aurora, turning listlessly on the water to aim its enormous cannon on the Winter Palace in a scene familiar to every Soviet viewer from the pseudo-documentaries of their childhood.

Tolik's Aurora is different. With no warning, it explodes in his skull, filling his mind with shrapnel and waking him from his dream.

He rises slowly, opening first one eye and fumbling with an ageing reel-to-reel tape-recorder as he threads a tape to break the silence in his room. When he presses the button, no music comes out. Instead, it is the voice of a radio announcer informing listeners that "yesterday, after a short illness, Comrade Joseph Vissarionovich Stalin left this life."

Tolik dresses quietly and listens to the famous announcement of Stalin's death. It is a ritual, we learn later, which he repeats every morning.

This is the opening scene of Sergei Soloyev's *Black Rose, Red Rose* (1990), a Soviet film released last month but it might as well serve as a metaphor for Soviet cinema in the age of perestroika.

After a brilliant beginning, film makers have got bogged down in the themes of the past, unable to find their footing among the new-found freedoms of perestroika. The result is an anomaly: now that censors have given film makers the right to say what they want, film makers are finding that in many ways they were more comfortable when they had something to fight.

Many people date the beginning of perestroika to the release of Tengiz Abuladze's *Repentance* (1987), a dark surrealist parody of the small-town dictator who resembles Stalin's henchman, Lavrenti Beria.

The humour is pointed and only loosely disguises the film's very serious purpose: an attempt to come to terms with pain and guilt left over from Stalin's times.

Vassili Pikul's *Little Vera* (1988) drew huge crowds when rumour circulated that the film contained explicit sex (then a Soviet first). Many went home disappointed – unaware that the sexual offerings were meagre and the film's message brutally depressing.

Still, in spite of much audience disappointment, critics hailed Pikul's work as one of the best Soviet films of the past decade – a haunting vision of the senselessness of modern Soviet life.

In spite of its Soviet origin, Latvian Juris Podnigekes's *Is It Easy To Be Young?* (1987), a stirring documentary about the anger and alienation of youth, remains one of the finest documentaries about young people's problems made anywhere.

These were good films but they appeared almost three years ago and perestroika has yet to top them. More recently, Soviet cinema has deteriorated into a hackneyed series of cliches unable to hold the attention of their audience.

Moscow critics have begun wondering out loud why perestroika can generate such good journalism and impassioned polemics could create such mediocre art.

What sensations there have been – like the release of Abuladze's *Repentance* and the publication of Anatoli Rybakov's *Children of the Arbat* – have come largely from works created in earlier times, when artists were still repressed and had to fight for the right to make anything.

Perestroika, for some reason, has been unable to produce its own metaphors. Why this is the case remains a mystery, although many feel the reason may be that artists have got too caught up in the political process itself. Certainly, many writers and film makers proved they could grasp the essentials of perestroika faster than party functionaries.

As a result, they were elected in droves to the new parliament, where they have given many fine speeches but not, alas, written many fine novels.

Films, too, have often been thinly-disguised polemics, eager to show the director's sympathies, but lacking in the humane vision as the basis of all great art.

Little Vera was hailed as of the best films of the past decade – a haunting vision of the senselessness of modern Soviet life

Charles Leadbeater on the cinema industry

Lack of dynamism

"WHEN families are happy they are alike. When families are unhappy they are unhappy after their own fashion." Mr Arthur Yerkamov, executive secretary of the board of the USSR Union of Film Makers quotes the opening lines of *Anna Karenina* to sum up the state of his industry.

Perestroika has not been accompanied by a flowering of Soviet film making. While society's political imagination is being unlocked, film has not unlocked its cultural horizons.

Instead there has been a flood of documentary films focusing on previously closed areas of Soviet society, drugs, alcoholism, corruption in the Communist Party, the role of the mafia and prostitution.

Mr Yerkamov, an expert on early Soviet cinema says: "Revolution is a very difficult time for art. If you examine the October Revolution, good art only started to appear in the 1920s after the revolution was consolidated."

Yet the confusion of revolutionary times is only one explanation for the lack of dynamism. The other is that institutions and habits of Stalinism were deeply ingrained within the industry, from the way Goskino, the state film committee, selected films to the way directors conceived them. It will take a long time to rid the industry of them.

That is the goal of a far reaching restructuring plan drawn up by the union. Under the old system Goskino used to select which films to make, vet the screenplay, chose the actors, calculate the budget, appoint the crew and then oversee the film's eventual screening.

The plan, which was called for by the 5th Congress of Film Makers in 1986, is a case study of the bureaucratic opposition to reform. After a lengthy struggle with Goskino, leading film makers met Mr Nikolai Ryzhkov, the Prime Minister, in May last year to present their plan in the presence of all the relevant ministers. The Prime Minister called for the final plan to be presented by the ministries a month later.

Under the new system, which is being formally introduced this year, the union will take responsibility for supervising the industry. Goskino is intended to take a subordinate role. All the USSR's 39 studios will be given freedom to chose which films they will make and who to employ on them.

One of the most important aspects of the plan is to create a labour market for creative staff. Technical staff like engineers and administrators will be full time employees of the studios. But creative staff like camermen and actors who used to be full time employees of studios will in future be employed on contracts for the duration of the film's production. Their salaries will be linked to the film's profitability.

According to the union, there is considerable scope for financial disaster in the industry. Mr Yerkamov says: "Some studios must go bankrupt." Indeed, some of the 10 separate studios created at Mosfilms are already technically bankrupt, according to the union.

This move towards self-financing among studios is only the first stage. Last month the union set up an association of independent co-operative film makers to act as an innovatory, competitive force.

Mr Ryzhkov is considering a union proposal that all studios should become co-operatives by 1994, when the last remnants of the old system should be completely eliminated.

But this transformation in production is unlikely to transform the industry unless there are complimentary moves among distributors and cinema halls.

There have been tentative moves towards a freer distribution market. Last year the unions and the state committee organised a series of film auctions at which distributors bid for new films. Prices ranged from Rbs12 per copy to more than Rbs12,000.

"We discovered for the first time that there were lots of films that no one really wanted to watch and which did not even cover the costs of their production," said Mr Yerkamov.

The auctions also uncovered another threat to plans for a more open market: distributors had started organising themselves into groups to act as monopolists.

The union has identified another dilemma familiar to broadcasters and film makers in the West. Without having got anywhere near creating a free market it is already worried by creeping commercialisation.

"To operate in the international market we have to make popular commercial films. But if we let commercialisation take over that will be the end of cinema," says Mr Yerkamov

BUSINESS GUIDE

Test of nerves

DOING business in Moscow reminds one of the 19th century recipe for game stew which starts with the sound advice: "First catch your hare . . ."

In the case of the foreign businessman who has decided to tackle the Soviet market, a similar approach is appropriate. It is a question of putting aside sophisticated marketing techniques and equipping yourself psychologically for solving some basic problems.

The key question is how to begin to set up meetings with Soviet foreign trade organisations, ministries and other possible future business partners. It is not such a silly question as it sounds.

There are two main obstacles and it helps to be aware of them at the very outset: first, central switchboard systems are unknown in the Soviet Union, so everyone has a separate telephone number. But if someone is not at his or her desk for a day, or two or more, then the telephone will not be answered, as many employees do not seem to have secretaries. Do not pin your hopes on a number which does not answer – look for alternative contact numbers in the same organisation.

Incidentally, the same is true of hotel rooms: you will have a direct phone number, whereas the hotel switchboard cannot be relied on to take messages or pass on calls (with the honourable exception of the newly-renovated Savoy Hotel). So if you expect anyone to contact you during your stay, give them your direct number – and be prepared for calls after midnight.

Second, there are no telephone directories as we know them. The closest you will come is an invaluable publication called *Information Moscow*, available at some Intourist desks, at Collets bookshop in London, at the Soviet-Swiss joint venture Sadko in Moscow or direct from the publisher.

The best way to save time and frustration is to find Russian speakers to set up appointments and meetings for you. Many of the international chambers of commerce based in Moscow provide such a service and can give very useful advice and contacts.

If you can, follow the example of the more experienced international businessmen who base themselves at the World Trade Centre, the concrete complex built by Dr Armand Hammer on the banks of the Moscow River, diagonally opposite the Ukraine Hotel. Many of the chambers of commerce, international airline offices and Vneshekonombank, the Soviet Bank for Foreign Economic Relations, are there.

On the second level at the top of the escalators is the Service Bureau which will send your telexes and fax messages, and make international calls. Thereby hangs another tale. Outgoing international calls from Moscow are charged at between three and five times the rate you would pay to call Moscow from the West from an automatic telephone. On regular Soviet phones you may have to wait six hours or more for an operator-booked call.

The so-called dollarisation of the Soviet Union has gathered pace over the past year or so. Foreign visitors can find many more services than they used to, but almost all payable in foreign exchange. Even though visitors can now benefit from a much more favourable exchange rate for their cash – 10 times the official rate – there is very little they can spend their roubles on. Having such a favourable legal exchange rate reduces any residual temptation you may feel to use the black market – unwise at the best of times.

If you do find yourself with a surplus, then one possibility is to get your Soviet partner to book a table or hire a car on your behalf. Then it should be possible to pay in roubles.

The choice of restaurants is improving all the time, although many now insist on payment in hard currency. Do not give in willingly – a compromise is to pay for the food in roubles, and the drink in dollars. Try U Pirosmani for Georgian food, U Yuzefa, a Jewish co-operative, Kropotkinskaya 36 – the first co-operative cafe in Moscow – or Glazour, for an upmarket meal.

If none of those take your fancy, you can always queue at McDonalds in Pushkin Square. You can get a Big Mac in about one hour.

Ubiquitous black Volga cars can be hired in all the international hotels – at around seven 'hard roubles' per hour. They are good value and an excellent way of reducing the stress of a busy schedule.

If you are not a Russian speaker it is wise always to check before a meeting whether your Soviet partners speak your language – the onus will invariably be on you to provide an interpreter. Book through your hotel in advance and expect to pay around 70 'hard roubles' a day, but do not hesitate to ask their help for making appointments, bookings and enquiries!

Of course the most important item is your visa, which officially now only takes 48 hours from receipt of the written invitation from your Soviet partner. Getting the invitation is what takes the time. However, it is now possible for a businessman to come as a tourist in order to find a suitable partner.

With the upsurge in international interest in perestroika, accommodation is at a premium in Moscow. Several new hotels are planned, but they will not be built until the rush is over. As a result, room prices for foreigners have soared, and you may have to pay at least $200 for a room which anywhere else would cost half.

Hotel bookings can be made through a limited number of organisations: in London, Intourist, Thomas Cook or Barry Martin Travel, a company which specialises in business travel to the USSR. If you still have no luck, then try Airtours, the only joint venture travel agent in Moscow, which can find rooms in hotels not normally open to foreigners.

Travel within the country will have to be arranged through Intourist, not one of the world's great travel agents. Nor is Aeroflot, in spite of some recent efforts, one of the world's most accommodating airlines.

Useful telephone numbers:
USSR Chamber of Commerce: 923 4323
British-Soviet Chamber of Commerce: 253 2554
Information Moscow: 135-1164
Zhilcoop: 262-9330/975-3486
Airtours: 457-6678/6778
(telex: 411935)

Quentin Peel and Bobby Meyer